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In the

Supreme Court of the United States

October Term, 1975

TSC INDUSTRIES, INC., A Delaware Corporation, NATIONAL INDUSTRIES, INC., A Kentucky Corporation, And TSC INDUSTRIES, INC. (Formerly Named NII, INC., And Being The Successor To The Business, Assets And Corporate Name Of Said TSC INDUSTRIES, INC.), A Delaware Corporation,

Petitioners,

vs.

NORTHWAY, INC., A Delaware Corporation,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit.

RESPONDENT'S BRIEF

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

No. 74-1471

TSC INDUSTRIES, INC., A Delaware Corporation, NATIONAL INDUSTRIES, INC., A Kentucky Corporation, And TSC INDUSTRIES, INC. (Formerly Named NII, INC., And Being The Successor To The Business, Assets And Corporate Name Of Said TSC INDUSTRIES, INC.), A Delaware Corporation,

Petitioners,

vs.

NORTHWAY, INC., A Delaware Corporation,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit.

RESPONDENT'S BRIEF

Respondent, Northway, Inc. answers the brief of Petitioners National Industries, Inc. and TSC Iudustries, Inc. as follows.

QUESTION PRESENTED FOR REVIEW

The sole question presented and available for review by this Court should be:

Whether the evidence in the record below, establishing without genuine controversy the omission of numerous admitted and uncontroverted facts from the proxy statement, evaluated in the light of the contents of the proxy statement and the governing regulatory policies, was sufficient to establish a violation of Rule 14a-9 as adjudicated by the entry of partial summary judgment on the issue of liability?

STATEMENT OF THE CASE

The origins of this litigation are in the terms of the exhange offered by National Industries, Inc. (National), a defendant below and petitioner here, for the purchase of all the assets of TSC, Inc. (TSC), the defendant-petitioner in whose right this derivative action was brought.

National was an active and voracious conglomerate, having acquired some twenty-five companies in take-overs during the five years preceding this acquisition. A.285-98. TSC was a successful retailer operating some 221 stores, and had been formed by merger in early 1968. A.298-99.

In January, 1969 National acquired from TSC's principal stockholders, the Schmidt family, approximately 34% of TSC's preferred and common stock for cash and notes totalling about $23 million. Eight months later, in November, 1969, National and TSC joined in issuing the proxy statement at bar (A.259), offering to acquire all the assets of TSC in exchange for National B preferred stock and warrants exercisable at $21.40 per share, to buy National common (National common was then selling at

about $10.00). Based on November 7, 1969 market prices shown in the proxy statement the securities so offered to the TSC stockholders who held 66% of the TSC stock had a nominal value of only $27 million.

The terms of the exchange gave the TSC shareholders 45% of their total consideration, at market values, in the form of warrants which gave them no position as equity holders or earnings participants in National (A. 312), and which would require them to pay some $53 million to attain an equity and earnings position. A.530 n.j. The warrants expire in October, 1978, and since their issuance, the market price of the National common has never approached the exercise price of $21.40. To the extent of these warrants, the acquisition was accomplished at no cost to National, with no dividend obligations or equity dilution.

The transaction was intentionally arranged as a taxable transaction for the benefit of National which had a $10 million capital gain on other transactions to offset. The paper loss in this acquisition from itself of its TSC shares amounted to $13 million (Pl. Ex. 327-328)[1] and produced an actual cash saving to National of some $3.5 million. Peterson, a TSC shareholder who was also a

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[1] Exhibits, depositions and other documents which appear in the Joint Appendix are cited "A. .....". Exhibits which do not appear in the Joint Appendix are cited "Pl. Ex. ....." for Plaintiff's Exhibits and "Def. Ex. ....." for Defendant's Exhibits. All exhibits are bound in numerical order in 22 acco binders. Vol. 1 lists all exhibits.

Depositions which do not appear in the Joint Appendix are identified by name of deponent, date of deposition and page number.

director, was bought out for cash and notes because of the the capital gain he would incur in the exchange. In consequence he abstained from voting as a director on the proposed transaction. A.414. The non-director shareholders were left to deal with their tax problems as best they could.

Aggrieved by the gross inadequacy of the consideration paid by National in taking over TSC's assets and the substantial unfairness of the transaction to TSC's public shareholders, the owner of Northway, Inc. (a family investment corporation established by Saul Fellars[1] when he sold his small group of drug stores and retired) consulted legal counsel, and this action was filed derivatively, on the basis of Northway's 200 shares of TSC, on the day before the scheduled TSC shareholders meeting to vote the proxies on the proposed sale. Several other TSC shareholders intervened as plaintiffs, but are not participating in this appeal.

After completing discovery in obedience to the District Court's direction, including discovery on damages, Respondent filed its motion for partial summary judgment as to liability, relying on four documentary and uncontroverted factual grounds. The District Court denied the motion, but recognizing reasonable grounds for differences of opinion on controlling questions of law, made the requisite findings to permit interlocutory appeal under § 1292(b) of the Judicial Code, 28 U.S.C. §1292(b) (1948). The Court of Appeals unanimously reversed on three of the grounds, finding it therefore unnecessary to consider

[1] Mr. Fellars died during the pendency of this litigation, and his widow is now sole owner of plaintiff Northway.

the fourth,[1] and directed the entry of partial summary judgment on liability in accordance with the motion. The facts relevant to the grounds relied on by the Court of Appeals are stated in the Argument.

[1] The fourth ground of the motion for summary judgment not passed on by the court below arose on the following facts which present a pure question of law:

The proxy statement repeatedly states that the TSC board of directors has approved the proposed transaction involving the dissolution of TSC upon the sale of all its assets. A. 259, 265, 267. This recital was false. Under the applicable Delaware law, the shareholders could not be called upon to vote on corporate dissolution without the prior "adoption of a resolution to that effect by a majority of the whole board" of directors. 8 Del. Code Ann. §275 (1969), quoted in full at 512 F.2d, 337 n. 25. It is admitted that the "whole board" consisted of ten members; only four voted to approve. A. 411, 414.

Under these circumstances, there was no legal foundation for submission of the question to the shareholders, and the whole proxy solicitation was a sham. This ground entitles plaintiff to summary judgment, with no need for consideration of the recitals of the proxy statement or of the materiality of its nondisclosures. When the requisite board vote has not in truth been attained, no proxies may be solicited. See *Dillon* v. *Berg,* 453 F.2d 876 (3 Cir. 1971), affirming 326 F.Supp. 1214 (D.Del. 1971); *Dillon* v. *Scotten, Dillon Company,* 335 F.Supp. 566 (D.Del. 1971).

The Court of Appeals declined to reach this clear-cut question in view of the plain adequacy of the several other grounds for its holding that the proxy statement was misleading as a matter of law. 512 F.2d, 337. The opinion nonetheless notes, and quotes at length, the views of the authority principally relied on by the District Court, who explained that the District Court was in error in its interpretation of Delaware law. 512 F.2d, 337 n. 26, 27.

Respondent has not devoted a part of this Brief to argument of the point in light of the position taken by the Court of Appeals. However, Respondent does not thereby abandon this contention.

SUMMARY OF ARGUMENT

Part I of the Argument sets forth the three grounds relied on by the Court of Appeals for its holding that the proxy statement at bar issued by both petitioners jointly was materially misleading in violation of the securities laws, and that in consequence, respondent is entitled to summary judgment as to their liability. The joint proxy statement failed to disclose, among others, three categories of undisputed facts. These facts were of critical importance to TSC's shareholders in considering National's buy-out proposal which they were being urged by their directors and management to accept; facts bearing upon the apparent values being offered; the reliability of the market for the securities involved, and the independence of their own management and directors who were urging acceptance of the proposal. Part I contends that any one (and hence, all) of the three areas of undisputed facts omitted from the joint proxy statement is sufficient to support the judgment as a matter of law.

The first ground, considered in subpart A, pp. 12-24, is as follows: The proxy statement informed the TSC stockholders that the brokerage firm of Hornblower & Weeks-Hemphill, Noyes "had rendered a favorable opinion as to the fairness to the stockholders of TSC" of the terms of the deal which was considered by TSC's directors in approving it, and that the firm had considered among other things "the substantial premium over current market values represented by the securities being offered to TSC stockholders . . . ." The Hornblower firm had written TSC a letter to this effect, dated October 16, 1969. Based upon then current market prices listed in the proxy statement for the National convertible preferred stock and common stock warrants being offered there ~~did not~~ appeared to be an apparent "substantial

premium" — 27% for the TSC preferred and 22% for the TSC common.

But approximately two weeks before the date of the proxy statement the Hornblower firm on October 31, had written a letter to Mr. Yarmuth, National's president and chief executive and chairman of TSC's Board of Directors. This letter informed petitioners that in rendering its opinion, Hornblower concluded that the National warrants which comprised nearly half of the total apparent consideration to be received by the TSC stockholders, had a value not of the current $5.25 market price of the then listed National warrants, but of only $3.50. Taking the National warrants at $3.50 reduced the apparent premium to nearly nothing. Yet petitioners failed to reveal the later letter in the proxy statement and thus presented to the TSC stockholders only half of the Hornblower opinion.

Having chosen to tell the favorable part of the Noyes opinion and call attention to the apparent substantial premium based on current market prices, petitioners were obliged to reveal the full story. They cannot use as an excuse for not doing so an attempted distinction not supported by the letters between the "price" and "value." Nor can they use as an excuse ~~its~~ their claim that a single, indivisible opinion was really two opinions. Further, National cannot use as an excuse that the portion of the opinion embodied in the later letter was to be used only for "booking" the transaction or for accounting purposes. It was not used or intended to be used for tax purposes. If it was used, or intended to be used for "booking" the warrants, or for accounting purposes, these facts themselves were of key significance to the TSC stockholders and they were entitled to be told, but were not told, about them.

Part B, pp. 24-36, argues that the proxy statement was materially misleading in setting forth the market prices of the National securities and the closing prices on November 7, 1969 without disclosing the following: National had on its payroll Edward Merkle, president and chief executive of Madison Fund, a large NYSE closed end investment fund. In addition, Bernard Barnett, Nation's board chairman, was a director of Madison. During the two-year period preceding the issuance of the proxy statement and continuing to the very week that the terms of the transaction were being set, Madison and National made market purchases of approximately 260,000 shares of National common and $2,000,000 in National bonds convertible into common. During the period from National's acquisition of its 34% of TSC's stock from the Schmidts to the issuance of the joint proxy statement at bar, the purchases amounted to 8½% of the total trading ~~value~~ volume on the exchange. Madison purchases comprised as much as 66% of total market ~~value~~ volume in one week and National purchases comprised as much as 35%. In the three weeks immediately prior to the October 16, 1969 TSC directors meeting at which the deal was approved — also the period in which the terms of the exchange were fixed — Madison's purchases were 15%, 18% and 10% of the total weekly trading. The proxy statement failed to disclose any of the admitted facts concerning the relations between National and Madison or their purchases of National's common stock. Accordingly, the proxy statement was materially misleading in this respect.

There is no need, as National claims, for respondent to prove National-Madison collusion or a National motive to affect the market prices of the National securities. The TSC stockholders were entitled to have the facts presented so that they could draw their own inferences.

The third independent ground relied on by the Court of Appeals is set out in Part C, pp. 36-62: National and TSC had filed three reports with the SEC in each of which it was stated that National "may be deemed a parent of TSC" under SEC regulations. These SEC regulations, expressly adopted by petitioners, made clear that National as a "parent" had "control" of TSC, that is, it possessed "the power to direct or cause the direction of the policies and management" of TSC. Neither these reports, nor the statements contained therein, were revealed in the proxy statement. Moreover, the proxy statement failed to reveal that National's president had become chairman of the TSC board and therefore under TSC by-laws its chief executive officer and that National's executive vice president had become a member of TSC's executive committee.

Nevertheless the proxy statement without informing the TSC stockholders of the SEC reports, or of the key TSC positions held by top National officials, informed the TSC stockholders that TSC urged TSC stockholders "to mark your proxy FOR" the deal. The proxy statement by such omissions failed to make the full disclosure of the possible conflict of interest of TSC management. Such nondisclosure was contrary to the decisions of this Court in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972) and contrary to other authorities.

Such omissions, moreover, were explicitly condemned by this Court in *Mills* v. *Electric Autolite Co.*, 396 U.S. 375 (1970) where this Court sustained a summary judgment as to liability for a similar omission. A similar result is appropriate here, particularly since the facts at bar are even more compelling than those in *Mills*.

Part II of the brief, pp. 62-87, contends that the admitted nondisclosures, as a matter of law, violate the

proxy rules under any reasonable test of materiality. Subpart A, pp. 62-72, argues that consistent with this Court's holding in *Mills* the purposes and policies of the securities laws impose the most rigorous duty of full and fair disclosure in a joint management proxy statement urging approval of a buy-out proposal being made by the principal stockholder. Such a standard appears to be appropriate on several grounds: a proxy statement is a "full story" document. The proxy statement at bar, moreover, was written to induce the TSC stockholders to accept the National deal. In such a proxy statement half truths cannot be tolerated. Also relevant are the fiduciary relationships arising in part from top National management holding key TSC executive positions. Relevant, too, is the fact that a proxy statement is corporate suffrage in action. Intelligent exercise of the shareholder's franchise requires the full story.

The Court of Appeals correctly applied the test of materiality laid down by this Court in *Mills*. (Subpart B, pp. 72-87)

The basic concept, however the definition may be phrased, is whether a matter is important enough, in light of the legislative purpose, that the stockholders should be informed. Each of the three grounds relied on by the Court below clearly meets this test. Hence gossamer distinctions whether a matter "might be" or "would be" considered important by a shareholder are of no consequence here.

Under the cloak of arguing the definition of materiality, petitioners here seek to add as a further impediment to summary judgment a requirement that respondent prove "causation" or the probable effect of the omissions on the outcome of the vote. This Court in *Mills*, for sound reasons, rejected such a requirement. Petitioners should not be heard to advance contentions already found meritless.

ARGUMENT

I.

THE PROXY STATEMENT WAS MISLEADING AS A MATTER OF LAW ON THREE SEPARATE AND INDEPENDENTLY SUFFICIENT GROUNDS.

This case turns upon the facts. They are established without controversy by petitioners' admissions, records, and documents. The legal questions involved are neither novel nor complex, and are authoritatively answered by the clear sufficiency of the documentary evidence to establish at least three clear-cut nondisclosures and half-truths, in plain violation of the proxy rules, and particularly Rule 14a-9 of the Rules and Regulations promulgated by the SEC under the authority of §14 of the Securities Exchange Act of 1934, 15 U.S.C. §78n (1934). Any one of the three violations would, standing alone, support the judgment below. The nondisclosures concern the three matters of most vital interest to a shareholder who receives a proxy statement requiring him to vote on an offered exchange of securities: the gain he will receive in market values by making the exchange; the reliability of the market for the securities he will receive in the exchange; and the disinterestedness of the advice he is offered by his own corporate management and directors on the advisability of accepting the offer.

A.

THE PROXY STATEMENT WAS MATERIALLY MISLEADING IN URGING NOYES' OPINION OF A "SUBSTANTIAL PREMIUM OVER CURRENT MARKET VALUES."

1. The Court of Appeals Properly Held That Presentation Of Only The Favorable Portion Of The Noyes Opinion Constituted An Obvious Violation.

The proxy statement stated (p. 6)that the firm of Hornblower & Weeks-Hemphill, Noyes "had rendered a favorable opinion as to the fairness to the stockholders of TSC" of the terms of the deal. "In such opinion," the proxy statement added, "said firm considered, among other things, the substantial premium over current market values represented by the securities being offered to TSC stockholders . . . ." (A. 267).

The Proxy Statement presented (A. 271) the market prices on November 7, 1969 of the National and TSC securities, including the price of the National warrant: $5.25. From these prices the TSC stockholders could readily compute the apparent "substantial premiums over current market values." The premiums thus appeared to be about 27% for the TSC preferred, and 22% for TSC common.[1] Hence, on the prestige of a leading investment

[1] Computations are:

	TSC Preferred	*TSC Common*
National "B" Pfd. (at 16⅝)	$ 9.98 (.6 sh.)	$ 8.31 (.5 sh.)
National Warrant (at 5¼)	5.25	7.88 (1½ war.)
	15.23	16.19
Less TSC Market (pfd. 12); Common 13¼)	12.00	13.25
Apparent Premium	$ 3.23	$ 2.94
Percent Apparent Premium	27%	22%

banking firm, TSC's shareholders were encouraged to believe that this "substantial premium" was, in its opinion, "represented by the securities being offered" to them.

The language quoted above emphasizing the "substantial premium" was taken directly from the Hornblower opinion letter dated October 16, 1969 (A. 427) and presented to the TSC Board at its meeting on that date by Blanke Noyes, a TSC director and a partner of the Hornblower firm. (A. 411-13) But at Yarmuth's request[1] Noyes had written him a second letter dated October 31, 1969 (A. 519) in which he explained that in giving its opinion Hornblower had valued the National warrants, not at the current $5.25 market price, but at only $3.50.

The letter states in part regarding the value as of October 9 (when the terms were set) of the "warrants to be issued in connection with [National's] proposed acquisition of TSC Industries" (A. 427):

> "Our evaluation of these warrants was made from the point of view of the stockholders of TSC Industries, of which I am a director. In advising TSC as to the fairness of the offer from NII it was necessary to determine whether the value of the warrants was reflected by the market price of the outstanding 487,000 warrants on the day in question. We did so in the light of the fact that approximately 2.6 million additional warrants would be issued in connection with the acquisition.
>
> "After studying price relationships of other warrants traded publicly, referring to customary systems of warrant evaluation, and considering the particulars of the proposed acquisition, we concluded that the warrants in question had a value of approximately $3.50."

[1] Neither Yarmuth (Yarmuth dep. September 10, 1971, p. 58) nor Noyes (A. 156) could recall the reason for the request.

Neither this letter, nor the $3.50 warrant valuation was revealed in the Proxy Statement.

Disclosure of the omitted portion of the Hornblower opinion valuing the warrants at only $3.50 would have made plain to TSC's shareholders that the apparent "substantial premium" was illusory. The warrants appeared to comprise about 48% of the value of the total package offered to TSC common shareholders, and about 34% of the total value being offered to the TSC preferred shareholders. Noyes' $3.50 value, used in place of the $5.25 market price eliminated nearly 80% of this apparent premium, and reduced it to a matter of pennies. For the holder of TSC common stock, the actual premium, in the light of Noyes' full opinion, would amount to 31¢.[1] In the aggregate, for the TSC common and preferred shares combined, the full Noyes' opinion would have revealed a total premium of less than 5%, and of some $4½ million less than the Proxy Statement advertised.

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[1] The reduction in the apparent premium is calculated as follows:

	TSC Preferred	*TSC Common*
Apparent Premium (fn p. 12)	$ 3.23	$ 2.94
Less reduction on revaluation of warrant from $5.25 to $3.50	—1.75	—2.63
Reduced apparent premium	$ 1.48	$ .31
Percent Apparent Premium	12%	2%

The total reduction in apparent premium for the 511,838 shares of TSC preferred, and 1,332,870 shares of TSC common not held by National was $4,401,164.

If a TSC shareholder discounted Noyes' $3.50 value for the National warrant by as little as a quarter of a point (25¢), the offered exchange ratio would have appeared to represent an absolute *loss* for TSC common shareholders.

The District Court erroneously denied summary judgment for this half-truth *not* because of any doubt about materiality, but because it was not "aware [of] evidence in the record" to support the fact that a warrant value of $3.50, as evaluated in the unfavorable portion of Noyes' opinion, rather than the $5.25 price listed in the proxy statement, "results in a very small premium, rather than the substantial one claimed." Pet. A. 43, 361 F.Supp. 108, 116. Since no evidence—but only simple arithmetic—was needed to show the evaporation of "substantial premium," the Court of Appeals did not hesitate to conclude that the omitted facts constituted a gross and "obvious" violation of the proxy rules. Pet. A. 17-18, 512 F.2d 324, 335.

2. The Proxy Statement's Emphasis on a Substantial Premium Over Current Market Values Concealed the Unfavorable Half of the Noyes Opinion.

The fact of first importance to a shareholder facing an exchange offer is what it appears he will get in exchange for what he gives. Playing upon the TSC shareholders' natural and keen interest in their possible gain in the offered transaction,[1] the proxy statement assured them that "the investment banking firm of Hornblower & Weeks-Hemphill, Noyes rendered a favorable opinion as to the fairness to the stockholders of TSC" of the proposed exchange, and that this firm's opinion was based upon, among other things, "the substantial premium over

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[1] Yarmuth recognized this fact. He testified in his deposition (September 10, 1971, p. 39): "Of course we were well aware of the fact that when you acquire the remaining shares you have to acquire it to the advantage of the ontstanding .stockholders of the company, and we were trying to formulate various way in which to give the TSC stockholders more than they had at the time, otherwise we couldn't have acquired the stock."

current market values represented by the securities being offered to TSC stockholders . . . ." A. 267. It appeared to the TSC's shareholders, therefore, that they were being offered what the Hornblower firm regarded as a substantial 27% premium for the TSC preferred and 22% for the common with the National warrants being reflected at the $5.25 market price.

This clearly induced impression was but half true. To the knowledge of both petitioners joining in the Proxy Statement, it was the opinion of the firm expressed orally by Noyes at the October 16 TSC directors' meeting, that "some decline in the price of the warrants" (A. 413) should be expected. Prior to issuing the Proxy Statement, moreover, National and TSC were expressly admonished in the October 31 letter that it was *not* the opinion of Noyes' firm that "the value of the warrants was reflected by the market price of the outstanding warrants on the day in question", that is, $5.25. A. 519. On the contrary, they were told it was the opinion of the firm, "[A]fter studying price relationships of other warrants traded publicly . . . that the warrants in question had a value of approximately $3.50." A. 519. But the TSC shareholders being urged to accept the deal were not told this vital fact.

3. Having Chosen to Use Part of Noyes' Opinion, Petitioners Were Obliged to Reveal the Full Story.

It is unnecessary for the Court to decide here whether the mere listing of the warrant market prices, with no added inducement of reliance, would itself have been misleading without the addition of an appropriate cautionary note to the proxy statement's market-price schedules (A. 271) Such a caution, for example, might warn the reader that quoted prices for the limited number of warrants

already outstanding could not be taken as reliable indicators of the value of the warrants to be issued in the future, when the volume would be increased six-fold.

Nor is it necessary to decide here whether the reference to a "premium . . . represented by securities being offered" in the future would constitute a *per se* violation of the proxy rules, even if full disclosure were made, because it embodied a prediction of "specific future market values", singled out in the Notes to Rule 14a-9 as the first example of what may be misleading.[1] At the very least, the issuers were fully warned by the regulations that they were treading on dangerous ground in opening the subject of a "substantial premium", measured by market values, of "securities being offered" at a future date when and if the proposed transaction was approved.

Certainly, they were under no obligation to mention any market premium. But in any event, they could not reveal a piece of the story and then take refuge as petitioners seek to do (Pet. Br. 38) behind a policy cautioning against telling any of it, to hide the parts they prefer to conceal.

As the Court of Appeals put it, petitioners "chose to publish the good news and omit the bad news." 512 F.2d 335, Pet. A. 17.

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[1] 17 CFR §240.14a-9 Note (a). The District Court considered this question as doubtful, but concluded "that the implicit prediction of post-transaction market values here should be governed by the usual standards under Rule 14a-9 rather than upon what would amount to a *per se* test based upon Note 1 to the rule." Pet. A. 43-44, 361 F.Supp., 117.

4. The Proxy Statement Conceals Noyes' Distinction Between Market Value of the Warrants Already Outstanding and of Those Yet to be Issued.

National and TSC have argued here that the Court of Appeals imputed some contradiction or ambiguity in the Noyes opinion, requiring a trial to appraise his credibility. Pet. Br. 38-39. But there is no contradiction or ambiguity in the opinion considered as a whole. At the TSC Board meeting of October 16, 1969, Noyes presented a letter bearing that date, containing the quoted reference to the "substantial premium." A. 428. Noyes confirmed that this "substantial premium" language in the Hornblower opinion referred to the then current prices for National's convertible preferred and common stock warrants being offered in the exchange. A. 160, 163-4.

At the same Board meeting Noyes presented the other half of his opinion, omitted from the proxy statement. Although "there may be some decline in the price of the warrants," he advised the board orally, "the exchange offer is a fair one." A. 413. In his October 31 written response to a question from Yarmuth, Noyes gave an explanation of the cause of this probable decline and his $3.50 valuation of the warrants to be issued to the TSC stockholder (see p. 13 ante): "The fact that approximately 2.6 million additional warrants would be issued in connection with the acquisition," while there were only "oustanding 487,000 warrants" at the time. A. 519. Thus, the letter added, "it was necessary to determine whether the value of the warrants was reflected by the market price of the outstanding 487,000 warrants on the day in question." A. 519. The answer was clearly no. "After studying the price relationships of other warrants traded publicly" and other factors, "we concluded that the warrants in question had a value of approximately $3.50." A. 519.

In short, the market price of the then outstanding 487,000 warrants was not an accurate measure of the likely market price when an additional 2.6 million warrants would be outstanding. The former was $5.25, the latter, which the TSC stockholders would receive, a likely $3.50.

Cutting this integral opinion into two pieces, the proxy statement omits any reference to the value of the warrants not yet issued and thereby conceals the critical distinction drawn by Noyes between the two groups of warrants. The TSC shareholder was led to believe that in the Noyes firm's opinion the "substantial premium over current market values" was, on the basis of the $5.25 market price of the existing warrants, represented in part by the 2.6 million warrants not yet issued—a belief directly contrary to the fact. The misleading impression was enhanced by the concluding phrase, "represented by the securities *being offered* to TSC shareholders." A. 267, 428.

Kept in ignorance of Noyes' clear distinction between present and future warrants, the shareholder could make no differentiation between the *presently outstanding* warrants and the *unissued warrants* of the same type being offered to TSC stockholders in the future. The half-opinion in the proxy statement thus clearly indicated that the securities to be offered to him would carry the "substantial premium over current market values" which he was invited to compute for himself.

5. The $3.50 Value of Warrants Yet To Be Issued Was An Integral Part of Noyes' Opinion.

In a transparent effort to sweep around this plain violation, petitioners offer a newly devised argument not presented below and advanced for the first time in this Court. Now for the first time they assert that Noyes' letter of opinion dated October 31, 1969 (A. 519) bore no relation to his October 16 opinion presented to the TSC board and to the TSC shareholders in the proxy statement, but was rather a wholly independent evaluation of the warrants for the exclusive use of National.[1] The reason, they claim, that Yarmuth obtained from Noyes the October 31 opinion valuing the warrants at $3.50 was to secure Noyes' opinion of the "intrinsic value" of the warrants to be used in "booking" the transaction (Pet. Br. 36, 37, 38).

This contention simply cannot be sustained. Whatever use National may have chosen to make of this $3.50 valuation of the warrants to be issued, Noyes' purpose in writing the letter is plainly stated in the letter itself. Its second paragraph makes it clear beyond peradventure that Noyes was clarifying and explaining the basis of his opinion, for the firm, as rendered to the TSC board. The valuation of the warrants as of October 9 (the date of the conference in which the exchange ratios were settled, A. 149) "was made from the point of view of the stock-

[1] For purposes of this argument, petitioners' brief transforms Noyes from TSC's champion in bargaining with National, as portrayed by their "control" argument (Pet. Br. 29) into the private adviser of National exclusively. The recipient of the letter, Stanley Yarmuth, undergoes the same chameleon-like transformation: his position as chairman of the TSC board completely disappears, and he is described solely as "National." Pet. Br. 36, 37, 38.

holders of TSC" (A. 519), not for purposes of National's needs, and was stated to be for the purpose of "advising TSC as to the fairness of the offer." (A. 519) It was not, as National now pretends, an appraisal of "intrinsic value" for National's own "booking" purposes.

Whatever National might have wanted, what National got in this letter was an integral part of Noyes' indivisible opinion. Whatever use Yarmuth intended or made of the Noyes letter is of no consequence. Whether requested or volunteered, this letter with its $3.50 valuation was not divorced from the firm's opinion, but was on the contrary a "predicate" of that opinion as petitioners expressly admitted in their answer to the complaint. A. 52.[1]

Petitioners' attempt to create a dichotomy between the "price" and "value" of the warrants, to separate the October 31 letter from the rest of the Noyes opinion, into "two different things" (Pet. Br. 36-7), founders upon the same facts. In the first place, the attempt loads more freight than Noyes' word usage can carry: his repeated phrase "current market values" would be self-contradictory if "value" were a quality wholly distinct from market quotes. But more importantly, Noyes' letter was not concerned with the value of the warrants in some abstract or "intrinsic" sense (Pet. Br. 38), unrelated to the market. He was faced with the intensely practical question whether the market price of the already outstanding warrants

[1] Corporate Defendants' Answer, Paragraph 14(k), recites "that they admit that Hornblower & Weeks-Hemphill, Noyes predicated its opinion not only on the entire number of actively traded, existing National warrants but also those to be issued to TSC shareholders, on the basis of $3.50 per warrant rather than the then-current market price of $5.25." A. 52.

fairly reflected the worth of what the TSC shareholders would receive in the exchange in the form of the warrants not yet issued. A. 519. His answer was negative, since there would be "some decline in the price of the warrants" (A. 413) with the flood of 2.6 million more on the market. Studying "price relationships of other warrants traded publicly" (A. 519), he arrived at a figure of $3.50. He was right. When the warrants were later issued and traded on the American Stock Exchange, their market value was $3.50.[1]

What about the National contention (Pet. Br. 36-38) that it intended the Noyes' $3.50 opinion as an opinion of "intrinsic value" for "booking" a taxable transaction? National's intentions in this regard are irrelevant to the issue of disclosure of Noyes' opinion. But even accepting its relevance *arguendo*, this argument, too, will not stand analysis.

The proxy statement declared that the transaction was a taxable transaction in which National sustained a tax loss. A. 270. In the proxy statement National explained that it would incur a tax loss based on the difference between the cost to it of the TSC stock it had previously purchased and the "fair market value" on the date of distribution of the National securities it would exchange

[1] The National warrants to be received by the TSC stockholders began to be traded on a "when issued" basis on December 8, 1969, on the American Stock Exchange. The "when issued" warrant closed the first week of trading on Friday, December 12 at 3½. (Wall Street Journal quotations)

Since issuance, the market value of the warrants has continued a downward slide. Since they confer only the right to pay $21.40 for National common obtainable on the market for about $6, the warrants currently trade in the one dollar range.

for its TSC securities (A. 270). It was further explained that based on the then "current fair market value" of such securities the National tax loss would be about $9,200,000. The $9,200,000 estimate was supported by a work sheet (Pl. Ex. 329) showing a tax loss of $9,228,254 based on November 7, 1969 *market prices*—16⅝ for the National "B" preferred and 5¼ for the warrants. The transaction was purportedly approved by the National and TSC shareholders at their respective meetings held December 5, 1969. A final computation was made early in 1970, based on December 5, 1969 *market prices*, showing a tax loss of about $13,000,000 (Pl. Ex. 327 and 328). Thus Noyes' opinion of the $3.50 warrant value had nothing to do with the determination of the tax loss.

Nor is any excuse for this omission of the full Noyes opinion provided on a theory (Pet. Br. 37-8) that the $3.50 warrant value was to be used by National in putting the TSC deal on its books for other accounting purposes. It is possible that National, prior to the issuance of the proxy statement, may have intended to book the transaction, valuing the warrants at $3.50. It is possible, moreover, that somewhere in the proxy statement schedules National may have valued the warrants at $3.50, but concealed this fact from the TSC stockholders. If, as National now suggests, it did any of these things, or intended to do any of these things, it had no business selling the deal to the TSC stockholders on the basis of the higher $5.25 market price. National should not be permitted to play up market value as an inducement to the TSC stockholders to approve the deal while keeping silent its intention to "book" at a far lower price.

The proxy rules are directed precisely at deceptive solicitation, and no citation of authority is needed to

establish that deception of the magnitude at bar constitutes a clear violation of the securities laws. In *Schein* v. *Chasen*, 478 F.2d 817 (2 Cir. 1973), a revised estimate of earnings which reduced the prediction by twenty-odd percent was sufficient to impose liability on those who had failed to disclose the revised opinion. See also *Chris-Craft Industries* v. *Piper Aircraft Corp.*, 480 F.2d 341 (2 Cir. 1973), where the shareholders were given book values without disclosure of the opinion that book exceeded probable market value of the assets.

Here the joint proxy statement exploits the Noyes observation of a substantial premium at current market values, with its plain propensity to affect the voting process and to garner shareholder approval. Having put forth half the truth because of its materiality in their favor, the petitioners cannot be heard to say that the whole truth is immaterial.

B.

THE PROXY STATEMENT WAS MATERIALLY MISLEADING IN URGING NATIONAL MARKET PRICES TO INDUCE TSC SHAREHOLDER APPROVAL WITHOUT DISCLOSURE OF THE ADMITTED MADISON-NATIONAL STOCK PURCHASES AND AFFILIATIONS.

The admitted substantial purchases of National common by Madison Fund (a large closed-end mutual fund listed on the NYSE) and by National, and the affiliations between them, constituted additional undisclosed facts which were critically important to the TSC shareholder faced with the necessity of making his decision and casting his vote. Like the omitted portion of the Noyes opinion, these undisclosed market activities related to the soundness and reliability of the market prices exploited by the proxy

statement and urged upon the shareholders as factors important to their decisions. Again, the Court of Appeals correctly ruled that these nondisclosures constituted a clear violation of Rule 14a-9. 592 F.2d 333-34, 335-36, Pet. A. 18-19.

1. The Omitted Facts Concerning These Substantial Purchases and Affiliations Were Critically Important to the Reliability of Market Prices as Decisive Factors.

The basic and operative facts are not in dispute. In urging a favorable vote, under the heading "Boards of Directors Approval", the proxy statement repeatedly calls attention to "recent market prices of the securities" (first paragraph, A. 267), "the current market prices of the securities", and "the substantial premium over current market values" (second paragraph, A. 267), as basic to the favorable opinions of both the TSC board and Noyes' investment banking firm. This emphasis on market prices is followed quickly by a full page devoted to a tabular presentation of comparative prices with quarterly highs and lows for the years 1968 and 1969, and the current New York Stock Exchange closing prices on November 7, 1969. A. 271.

These blandishments are not accompanied, however, by any disclosure of the fact that during the same two years, National and Madison had purchased some 260,000 shares of National common and $2 million in National bonds convertible to common (A. 547, 549, 558), that National's board chairman (Bernard Barnett) was also a director of Madison, and that Madison's president and chief executive (Edward Merkle) was a paid employee of National. A. 520, 522, 38, 51.

Merkle, while serving as President and chief executive of Madison, was carried also as a salaried employee of National, with special options for 10,000 National common,

Under his employment agreement Merkle agreed "to provide at least one day per month" for such duties as might be requested by National. A. 520. Two days before he purchased $2 million in National bonds convertible to common, for Madison's account, his National salary was increased five-fold, to $12,000. A. 522. Thus, Merkle's secret arrangement called for a salary of as much as $1,000 per day.[1]

The Madison-National purchases of National common were substantial. They amounted to 8.5% of the total trading volume on the Exchange in the period beginning after National's acquisition of the Schmidt shares and ending with the issuance of the proxy statement. A. 547. In particular weeks of this period, the percentage of total weekly trading represented by Madison or National purchases reached highs of 66% and 35%, respectively, and in a majority of the weeks in which either traded, their purchases exceeded 10% of total weekly trading. A. 545-47.

During the three weeks immediately preceding the October 16, 1969 TSC directors meeting to approve the terms of its sale to National, Madison's purchases of National common amounted to 15%, 18%, and 10% of the total weekly trading. A. 546-47. This, too, was the period during which both of the meetings with Noyes took place and in which the final terms of the deal were fixed. A. 141-47.

The importance of this information to a consideration of the fairness of the transaction to TSC's shareholders is obvious. Like the TSC shareholders and the SEC,

[1] Yarmuth, National's chief executive, and Merkle were long standing friends. Yarmuth hired him as his "financial adviser". (Yarmuth Dep. December 16 & 17, 1971 pp. 11-15).

Noyes and his partners were not aware of these facts. They were not told of the payments being made to Merkle or the substantial purchases of National's common by Madison Fund. A. 173-74.

Madison's purchases were disclosed to Noyes during his deposition, and he was asked if knowledge of them would have made any difference in the Hornblower opinion with respect to the fairness of the transaction. His answer, though reluctant, was a clear recognition of the importance of this information. "I can't answer that question off the cuff," he said, "[i]t would require a good deal of study . . . ." A. 176-77.

These omitted facts were critical to any intelligent evaluation of the significance of the market quotations urged upon the TSC shareholders. Established by National's own records and uncontested in the courts below, these facts were not disclosed in the proxy statement.[1] But they had a vital bearing on the reliability of the market quotations which TSC's shareholders were being asked to consider in appraising the deal and the apparent "substantial premium" being offered to them. A. 267, 271.

As the Seventh Circuit held, the TSC stockholders had the right to know of these facts, to draw their own infer-

[1] Petitioners' brief does not contest the Court of Appeals' sound holding that National's own purchases were not adequately disclosed by the scattered clues buried in the appendix' financial statements and their flurry of footnotes dealing with capitalization, not market prices, and more than fifty pages away from the market quotations they related to. 512 F.2d, 335 n. 20, Pet. A. 10, n. 20.

The numbers of shares purchased by National and Madison are taken from petitioners' admissions. A. 547 Note. The different figures offered in Petitioners' Brief, p. 40, are neither cited to nor supported by the record.

ences, and make their own evaluations. 512 F.2d 335-36, Pet. A. 19. Omission of these facts made the market-price sales pitch in the proxy statement materially misleading under Rule 14a-9.

2. The Significance to TSC Shareholders of These Omissions Does Not Depend Upon Collusion as a Prerequisite.

With no disclosure of these purchases by, and connections between National and Madison (facts fully known to National),[1] the TSC shareholders were left with the proxy statement's inducements to rely on market prices but without vital facts raising doubts about the reliability of that market. Because the bare facts bespeak so loudly the possibility of conspiratorial manipulation, the District Court[2] and the petitioners here (Pet. Br. 39-42) have labored under the misapprehension that Northway is arguing that collusion is established beyond controversy

[1] National's purchases of its own stock were of course known to National and to its officers (Yarmuth and Solomon) who were at the same time two of TSC's key directors. The Madison purchases were promptly reported to National, and these reports were regularly supplied to and examined by these officers. A. 225-26, 256-57. Whether they knew of each Madison purchase in *advance* (Pet. Br. 41) has no bearing on the duty to disclose.

[2] As the District Court correctly discerned, the only word in the lengthy complaint which might be construed as charging motive is "coordinated" (A. 39), used to describe the remarkable coincidental phenomenon that National and Madison never purchased shares in the same week, although National bought in ten weeks in the period and Madison in nine. But the District Court erred both in stating that plaintiff argued that defendants had a duty to disclose only if National "caused" Madison's purchases, and in holding that National had no duty to disclose potential manipulation which it was fully "aware of, but did not cause". Pet. A 42, 361 F.Supp., 115-116.

by these facts. That is not the ground of the motion for summary judgment, as the Court of Appeals properly understood. 512 F.2d 336, Pet. A 19.

The duty of disclosure does not depend upon a final factual determination that there was collusion in the National or Madison purchases, nor upon indisputable proof that they acted as petitioners claim "for any reason other than their own respective proper corporate or investment purposes, unilaterally and independently determined." Pet. Br. 42 The possibility that Merkle made Madison's purchases "unilaterally" without orders or requests from National does not destroy the importance of those purchases to the reasonable TSC shareholder.

The facts were brought to light through discovery in this case, over petitioners' determined and protracted opposition, upon public announcement of the SEC's independent proceeding against Merkle, charging him, among other things, with violating the disclosure requirements of the securities laws by causing Madison "to purchase 182,500 shares of National Industries, Inc., common stock and National convertible bonds in the principal amount of $2 million without disclosing that he was a salaried employee of National . . . ." *In re Merkle*, SEC Release 7280, Investment Company Act (1972), set out in full at A. 564.[1] The SEC did not charge "collusion" or tacit agreement. Rather, disclosure was required to alert Madison investors to Merkle's conflict-of-interest position, to allow them to judge for themselves which of his two em-

[1] The proceeding against Merkle was disposed of, upon his consent, with a finding that he committed the violations and with a 60-day suspension from any securities investment occupation. A. 5644.

ployers he was serving by the purchases. The potential influence of National's interests was a consideration equally important to TSC shareholders, and they were equally entitled to judge for themselves whether he was buying in National's interest.

3. Similarly, the Significance to TSC Shareholders of These Omissions Does Not Depend Upon Motive as a Prerequisite.

Congress, the Commission, and the courts have ruled out the superfluous additional elements which petitioners argue must be determined as facts to establish the materiality of the Madison-National purchases and connections. There is no need for a showing that the purchases were made for an evil motive, or "for any reason other than their own respective corporate purposes". Pet. Br. 42. "Neither the Commission nor the courts should be required 'to separate the mental urges' . . . for '[t]he motives of man are too complex to separate.'" *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200-01 (1963). The legislative history emphasizes that motive is irrelevant to the investor's right to be fully informed of a corporation's purchases of its own stock:

> "*Whatever the motive* behind a repurchase program, if the repurchases are substantial they will have a significant impact on the market price of the security. The shareholders of a company and other persons interested in the market price of its stock should have full information regarding the company's activities and intentions in repurchasing its own stock." Senate Report No. 550, 90th Cong., 1st Sess., p. 5 (1967). (Emphasis added.)

For the quoted reasons, it is also unnecessary to litigate as a fact question, as petitioners suggest, the extent to

which the purchases "affected the trend of high and low sales prices" (Pet. Br. 42) set out in the proxy statement. The layman, like Congress, needs no evidence to appreciate that if purchases "are substantial they will have a significant impact on the market price" (supra) and that adding 8.5% more purchases on top of existing market demand, as here, may well have invoked the law of supply and demand.

The SEC has long taken the position that its rules require disclosure of a corporation's purchases of its own stock, both to the investing public and particularly to the shareholders of another corporation who are invited to exchange their shares. In such a case, the SEC has charged that the disclosure rules are violated when an affiliated fund (a stock bonus plan) buys the issuer's common stock, or securities convertible into common, without disclosing to the shareholders of a corporation being acquired in exchange for the common stock that the Exchange price "would not reflect an independent consensus reached between buyers and sellers in a course of competitive trading, uninfluenced by the activities of the defendants."[1]

Elsewhere,[2] the SEC has forbidden the issuer of securities from making purchases of its own shares while they are being offered in an exchange to investors, premised

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[1] *SEC* v. *Georgia-Pacific Corp.*, CCH Fed. Securities Law Rep. ¶91,680 (S.D.N.Y. 1966). See also *Genesco, Inc. Prospectus*, SEC Rulings, CCH Fed. Securities Law Rep. ¶77,354 (1966). Both proceedings resulted in consent dispositions. Detailed disclosures, including daily volumes and prices, were required.

[2] Despite petitioners' reference to "market rigging", this is not a case where it is claimed that the purchases are unlawful in themselves, imposing liability to any trader in the market regardless of disclosure, as under §9(a) of the 1934 Act, 15 U.S.C. §78 (i)(a), or Rule

upon the Commission's expert conclusion that such purchases have an inherent propensity to mislead. The courts have properly refused to second-guess the SEC, or to require proof to support what the SEC has already determined by rule: that such purchases "will have a false prodding effect on the price of the distributed security and . . . the value of the exchange package." *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 378 (2 Cir. 1973).

Finally, there is no need for "evidence of a direct relationship between the market price of National Common" on the one hand, and National warrants or National B Preferred on the other. Pet. Br. 42. The warrants are nothing more than rights to buy National common at $21.40, and the preferred is convertible into three-quarters of a share of common. Again, the natural common sense of the shareholder would lead him to regard the common price as critically important to his choice, and the SEC rules confirm this conventional wisdom. The proxy rules *require* a listing of "the market value" of the common when warrants to purchase common are to be issued.[1]

The evidence here is not to the contrary. It is less than accurate to say that Mr. Noyes "clearly refused to

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10b-6. The plaintiff's position is rather that, however lawful, the purchases must be *disclosed* when the proxy statement urges reliance on market prices, under Rule 14a-9. The fact that Congress and the Commission have assiduously circumscribed such purchases, with limitations, prohibitions, and restrictions, nonetheless emphasizes their vital significance in the statutory scheme and their materiality as a matter of law regardless of motive or intent.

[1] Schedule 14A, Item 11(a) (iv), 17 CFR §240.14a-101. The SEC has also recognized the inextricable interrela-

regard the value of the Warrants as 'dependent' on the price of the Common Stock." Pet. Br. 42. On the contrary, Noyes testified that the market prices of National's common stock was relevant to Hornblower's considerations, "[b]ecause the value of the warrants and in part, the value of the convertible preferred were not—dependent isn't right—but related to the price of the common stock." A. 140. His further testimony makes clear that the market price of the National common was extremely important in the Hornblower evaluation of the National securities to be offered to TSC's shareholders, particularly the National common stock warrants. A. 147-48, 151-53, 157, 166-67.

Similarly, Northway's expert, Professor Nemmers, utilized the market price of National's common in valuing the warrants issued in the deal. As petitioners say, he made three analyses of these values. Pet. Br. 42. But each method of valuation employed the market price of the underlying common stock.[1] A. 539.

The SEC, pursuant to congressional mandate, has determined both legislatively and adjudicatively that purchases like those admitted here are inherently misleading. At minimum, and as a matter of law, such purchases, singled

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(Continued)
tions by prohibiting the issuer from purchasing a security (National common) when other securities convertible into it (National B preferred) or exchangeable for it (National warrants) are being offered in a distribution. Rule 10b-6(b), 17 CFR §240.10b-6(b).

[1] National's expert, Mr. Stiegelmeier, did not make an evaluation of the National warrants. However, even he testified that valuing the National warrants would require "[a]mong other things . . . a rather careful study of the common stock to which these refer." Stiegelmeier Dep. November 24, 1971, pp. 45-46.

out for a special condemnation and concern by Congress and the SEC, must be regarded as material, and must be disclosed.

4. The Congressional Purpose Protects the Shareholders' Right to Draw Their Own Inferences From the Admitted Facts.

The more basic fallacy of petitioners' argument is its pervasive premise: that there is no duty of disclosure as a matter of law so long as different inferences can reasonably be drawn from the admitted facts. Pet. Br. 27-8. The unstated assumption underlying the argument is that there would be no violation of the proxy laws if a jury concluded after trial that plaintiff had failed to prove that Merkle colluded or conspired with National, to prove that the reasons for the purchases were manipulative, or to prove that the market for National warrants or preferred was actually boosted by the common purchases.

The notion that these issues are committed to judicial determination is contrary to the whole thrust and purpose of the congressional plan. The enactment of §14(a) "stemmed from a congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange.' H.R. Rep. No. 1383, 73rd Cong. 2nd Sess. 13. The provision was intended to promote 'the free exercise of the voting rights of stockholders,' . . . [to] effectuate the congressional policy of insuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions." *Mills* v. *Electric Autolite Co.*, 376 U.S., 381 (1970).

In keeping with this policy, it is the *shareholders,* not the courts, who are vested with the power to decide whether the transaction should be approved. They are

entitled to decide for themselves whether to repose their confidence in questionable market quotations. The possibility that a jury might conclude after a trial that the market was or was not reliable does not deprive the shareholders of their congressionally conferred right to judge for themselves, with full disclosure of suspicious circumstances. Any other rule "would allow the stockholders to be bypassed. . . . A judicial appraisal of the merger's merits could be substituted for the actual and informed vote of the stockholders." *Mills* v. *Electric Autolite Co.*, 396 U.S., 381 (1970).

As here, when the admitted facts establish without genuine controversy an undisputed factual foundation of vital importance to reasonable TSC shareholders in making their decision, the congressional purpose demands that the shareholders' right to draw the inferences—favorable or adverse—must be protected. Thus petitioners' concluding characterization of the decision below is not so anomalous as they suppose; the congressional policy, in this sense, *does* "compel National in effect to try, via proxy material, the fact or issue [of conflicting inferences] before a jury of shareholders . . . ." Pet.Br. 42. The passage describes, fairly if metaphorically, the necessary effect of any disclosure law, requiring full and fair revelation of the material facts. *Mills* v. *Electric Autolite Co.*, 396 U.S. 375, 384 (1970). If, as here, adverse inferences are obvious, these may be denied in the proxy statement or accompanied by countering facts.

Here, the District Court was wrong in concluding that disclosure was required only if there had in fact been a joint rigging of the market and that only the jury had the right to draw such inferences from the undisputed facts. 361 F. Supp 116. The Court of Ap-

peals correctly divined the congressional objective: "But the purpose of 14a-9 is to allow the stockholders to draw such inferences as they see fit before their final decision on proxy questions."[1] 512 F.2d, 336. Pet. A 19.

C.

IT WAS A VIOLATION OF THE PROXY LAWS TO FAIL TO REVEAL TO TSC STOCKHOLDERS SIGNIFICANT FACTS FROM WHICH THEY MIGHT HAVE INFERRED NATIONAL CONTROL OF TSC.

1. The Proxy Statement Failed to Reveal Key Reports to the SEC and Key TSC Positions Held by Top National Executives.

Both National and TSC filed key reports with the SEC in which each made statements of critical importance

[1] With disclosure of the Madison-National purchases and relationships, a reasonable shareholder might have concluded, without inquiring further, that the circumstances were sufficiently suspicious that he wanted nothing to do with National or its securities. Or the stockholder—or his broker, investment adviser, the Exchange, or the SEC—might have chosen to look deeper, discovering that although National and Madison made purchases in nineteen separate weeks between National's acquisition of the Schmidt shares and the proxy statement, they never bought in the same week (A. 550); that purchases were concentrated in periods when National common was weak or when National released unfavorable earnings statements (A. 550-51, Notes E, F, and 552, Note L); and that purchases were also concentrated in critical periods in National's active campaign of corporate acquisitions, when the market price of National common would fix exchange ratios and determine the attractiveness of the offered transactions to the target shareholders. (A. 553, Note M, 554-57, Notes Q, V, W, X, Z, AA, BB, CC, and FF).

These facts stand undisputed in the record. The Court of Appeals correctly called attention to some of them in reaching its conclusion that the TSC shareholders were entitled to draw their own inferences.

concerning National's control relationships. On February 27, 1969 TSC filed its Form 10-K Annual Report as required by Section 13 of the 1934 Act. A.509. In response to Item 3, TSC stated

> "National Industries, Inc. may be deemed a 'parent' of the registrant [TSC] within the meaning of the rules and regulations of the Securities and Exchange Commission adopted under the Securities Act of 1933." A.512.

March 7, 1969, TSC filed its Form 8-K Current Report under the same Section 13. In response to Item 1 referring to changes in control, TSC specifically referred the SEC to this statement in its earlier 10-K. A.517. National made substantially the same statement to the SEC in its Schedule 13D filed February 14, 1969.

There is no ambiguity in this recital. Translated from legalese, the statement that "National may be deemed a 'parent' of TSC . . . as defined" means plainly that "it is permissible and correct to regard and to think of National as controlling TSC, that is, as possessing the power to direct TSC's management and policies."[1] There

[1] The key terms are defined in Rule 12b-2, 17 C.F.R. §240.12b-2, issued by the SEC under the Securities Exchange Act of 1934. Rule 12b-2(k) defines "parent" of a specified person as follows:

> "A 'parent' of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries."

The definition of an "affiliate" of a specified person is in Rule 12b-2(a):

> "An 'affiliate' of, a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified."

can be no doubt about what the recital meant. The definition of "parent" expressed by both National and TSC is clear. To be the parent of TSC meant that National controlled TSC—whether that power was exercised or not.[2]

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[1] (Continued)

Finally, "control" is defined in Rule 12b-2(f):

> "The term 'control' (including the terms 'controlling,' 'controlled by' and 'under common control with') means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

National's filing was under the Securities Exchange Act of 1934. It refers in its filing, however, to a "parent" as defined in the Securities Act of 1933. The SEC definitions of "parent," "affiliate" and "control" under the 1933 Act are identical to those under the 1934 Act. See Rule 405 under the 1933 Act, 17 C.F.R. §230.405.

The use of "deemed" to describe National's parenthood means simply that not literally but for purposes of the law it may be so regarded. *Cf.* 28 U.S.C. §1332(c) (a corporation is "deemed to be" a citizen); §1348 (a national banking association is "deemed to be" a citizen of the state where it is located).

[2] Petitioners' two affidavits, like the affidavits of no-influence filed by defendants in *Mills,* 403 F.2d 429, 434 (7th Cir. 1969), "miss the point". The correct question under the regulatory definitions is not whether National is "*in* control" (Pet. Br. 33) in the sense of giving daily orders, but rather whether National has "possession, directly or indirectly, of the power to direct or cause the direction of the management and policies" of TSC. 17 C.F.R. §240.12b-2(f). Once that power is possessed, there is no need to go further "'to separate the mental urges' . . . for '[t]he motives of man are too complex . . . to separate.'" *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180, 200-01 (1963).

The joint proxy statement, however, did not disclose the fact that these statements had been made to the SEC. Neither National's nor TSC's filings were disclosed. The proxy statement, moreover, did not explicitly state that National could be deemed to be the parent of TSC, or to control it, or to possess the power to direct its management and policies.[3]

Further, the joint proxy statement did not disclose key facts concerning the positions in TSC's management and on the Board of Directors held by the top executives of National. It was not disclosed that Stanley Yarmuth, a National director, its President and chief executive, was also the chairman of TSC's Board and therefore its chief executive officer under its by-laws. A. 445, 180. Also undisclosed, moreover, was the fact that Yarmuth was a member of TSC's 5-man executive committee. A. 467. Nor was it disclosed that Charles Simonelli, National's Executive Vice President and a member of National's executive committee, was also chairman of TSC's Executive Committee. A. 471.

These omitted facts were of vital importance to TSC's shareholders. They were being told in the joint proxy statement that their directors had approved National's proposal. A. 259, 267. They were being urged by their management to vote for the deal. A. 259. But they were not told these facts which had a crucial bearing on the potential conflict of interest and lack of independence of their own advisors, their own directors and own manage-

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[3] In contrast, however, a prospectus for the sale of 195,000 shares of TSC common, dated March 18, 1969, eight months before the proxy statement at bar, did state to potential investors that National may be deemed a parent of TSC. Pl. Ex. 106, p. 21.

ment—who were urging their acceptance of the transaction.

2. The Securities Laws Demand Full Disclosure of a Possible Conflict-of-Interest Position of One Offering Investment Advice.

The federal securities laws enacted in 1933 and 1934 rely upon disclosure as the principal means "to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economical health of the country." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963). "A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." 375 U.S., 186. In elevating these ethical standards, Congress focused upon conflicts of interest as a key concern. See Senate Report No. 1455, 73d Cong., 2d Sess. 12 (1934).

This Court, heeding the congressional concern, has directed full disclosure of a conflict-of-interest position occupied by one who undertakes to offer advice to a securities investor, declaring in *Capital Gains Research* that the recipient of the advice "must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving 'two masters' or only one . . . ." 375 U.S., 196

The same policy underlies the holding of this Court in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), that defendants Gale and Haslem, acting merely in an advisory and ministerial capacity, bore

a duty to disclose their conflict-of-interest position. "The defendants may not stand mute . . .", under Mr. Justice Blackman's opinion for the Court. "The seller had the right to know that the defendants were in a position to gain financially from their sales . . . ." 406 U.S. 153.

In this respect, the securities laws demand the same ethical standard traditionally imposed by courts of equity upon fiduciaries, compelling in all instances full disclosure of a conflict-of-interest position. "Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts' " including "disclosure of a conflict-of-interests." *SEC* v. *Capital Gains Research*, 375 U.S. 180, 194, 196 (1963). Here both corporations who joined in issuing the proxy statement bore an exacting duty. TSC's management and board of directors which included National's top executives, stood as fiduciaries of the shareholders' interests, and owed the utmost candor. This obligation was heightened by their voluntary undertaking not merely to report formal board action approving the transaction, but to offer advice and recommendations to the shareholders, urging them to vote for the sale. Clearly, important facts concerning this potential conflict of interest, and revealing that National may be in control of TSC were of vital concern to TSC's shareholders in considering the urgings of their own board and management to accept National's proposal.

3. A Possible Control Relation with the Adversary in a Proposed Transaction Must Be Disclosed to the Shareholders.

The supervening importance of control to the disclosure policies of Congress and the Commission is mirrored in

the practicalities of the workaday world of the investors and shareholders who are protected by these disclosure policies. In practicality, no factor is more important to the investor or shareholder than control.[1] The TSC shareholders who were being asked to accept National's deal could make no intelligent decision without knowledge of these facts indicating that National may be in charge, and on both sides of the bargaining table.

Petitioners' joint proxy statement stated that National had acquired 34% of TSC's voting stock, and that five of the ten TSC directors were National's nominees, while the remaining five holdovers were "not affiliated with National." A.267-68.

With no more information than this, the TSC shareholder was implicitly assured that the terms of the offered buy-out had been hammered out in equal bargaining between evenly divided factions, and were the best that could be attained by forceful representation of TSC's interests. In this light, he could safely repose his confidence in the assurance, on the cover page of the proxy statement, that TSC's "Management urges you to mark your proxy FOR this purchase of TSC assets by National . . . ." A.259.

The TSC shareholder was also lulled to believe that the "Board of Directors Approval", heading the proxy statement's critical page (A.267), contained within it the favorable votes of the five holdover directors who had no National affiliation. He had no cause to scrutinize the deal for himself, but could safely entrust his interests to these directors who, he was repeatedly told, "are of

[1] See Cohen, *A Note on Takeover Bids and Corporate Purchasers of Stock,* 22 Business Lawyer 149, 151 (1966).

the opinion that this acquisition is in the best interests of the shareholders" (Cover Page, A. 259), and who "have approved the Agreement and believe that the transactions contemplated thereby are in the best interests of the shareholders of both corporations . . . ." A. 267.

This confidence-inspiring portrayal takes on a very different color, however, if one omitted fact is added to the picture: TSC's own management has officially reported to the SEC that TSC is properly to be regarded as subsidiary of National, and under National's control. In plain terms, TSC's management had declared that it may be considered to be under the control of National. The issue of control was not "hotly disputed." Pet. Br. 34. The management of TSC was not resisting a National takeover and asserting independence; they had recognized expressly that TSC's "management and policies" were properly considered to be subjugated to National's "power to direct." There was no need for "any clear-cut battle" to determine who had control. Pet. Br. 33.

TSC's shareholders had vital need to know of these statements to the SEC. They were entitled to consider these omitted facts in deciding how to vote on the National proposal. With this disclosure, the TSC shareholder would have confronted a very different question in deciding how to vote. He could no longer take it on faith that TSC's management had obtained, in tough arms-length bargaining, the best possible terms for TSC. Once it is revealed that his bargaining representatives have reported themselves as being possibly subservient to the domination of the opposing interests of National, a grave and inescapable doubt arises about which side of the table they sat upon. Any presumption in favor of the offered bargain must then, in caution, be reversed,

to view the offered terms not as the best attainable, but rather as the least the offeror, National, thinks it can get by with.[1]

As the terms of the bargain struck become suspect with the disclosure of facts indicating National's possible control, so too does the advice of TSC's directors and management to accept them. The recommendations of your

[1] Petitioners' brief paints a portrait of Noyes as the tough bargainer, representing TSC's interests so vigorously that National acceded to his terms without argument or protest. See Pet. Br. 29-30. This argument, of course, is not relevant to the issue of disclosure of the statements made by both TSC and National concerning National's control relationship.

Moreover, with due warning, the reasonable TSC shareholder might have viewed the picture differently. Noyes' firm had received the benefit of being retained, after National's control was reported, as principal underwriter for a secondary offering of TSC stock originally planned for the purpose of selling Schmidt's shares. When that plan was aborted by Schmidt's sale to National, the offering was salvaged by "management's" decision to substitute treasury shares, with substantial commissions to Noyes' firm. A. 34, 51. The firm had previously received a $20,000 fee for approving National's terms for acquiring another subsidiary (Hawthorn-Mellody) as "fair and equitable." A. 34, 51. The shareholder might also have found it to be odd and unusual that the "bargaining" was conducted by Noyes and his partners, with no TSC officers or employees who were not also top National executives present at the meetings. A141-42, 151, 158. He might reasonably question whether they had conducted a thorough canvass for outside, competitive offers for TSC's assets, or whether the Noyes' firm was acting not as bargainer but rather at most as an impartial, objective appraiser of the offer, retained solely to render an expert opinion. A.267. Or he might fairly consider the possibility that Noyes' firm was in reality advising National on the minimum plausible offer, and that National offered no resistance because its own adviser was speaking.

adviser cannot be intelligently evaluated in ignorance of his recorded admission that your antagonist in the transaction may well have the power to call the shots. The "urgings" of management and the "opinion" and "belief" of the TSC board of directors were both inherently and irretrievably misleading without disclosure of the fact that TSC had made prior reports of National's possible control, or at least of the substantive content of those reports. TSC management's own understanding of its relationship to National was of vital importance to those whose proxies were sought, since an "adequate disclosure of this relationship would have warned the stockholders to give more careful scrutiny to the terms of the merger than they might to one recommended by an entirely disinterested board." *Mills* v. *Electric Autolite Company*, 396 U.S., 375, 384 n. 6 (1970).

4. The Potential Conflict of Interest Inherent in the Omitted Statements Concerning National's Possible Control Was Accentuated by the Position of TSC's Directors as Employees of National's Reported Subsidiary.

To the shareholder who is asked to vote on a proposed sale of his corporation's assets, a possible control relationship between his corporation and the prospective purchaser is vital information, critically important to his choice in any case. In this particular case, however, control carried a unique and unusual significance. Four of the five holdover directors of TSC, represented as "not affiliated with National" (A.268), were executive officers in the employ of TSC and its affiliates.[1] With

[1] The offices of Schaefer, DeForest, and Carl Sharfman are recited at page 7 of the proxy statement. A.268. A careful reader could find Peterson's office described on the preceding page. A.267.

disclosure of National's possible control, these four are revealed as potentially beholden to National for their jobs and their livelihood.[2] Once it is known that National may be deemed TSC's parent, then these four officer-directors are revealed as employees of a National subsidiary, who can no more be described as "not affiliated with National" (proxy statement, p. 7, A.268) than director Segell who, as an officer of a National subsidiary, was excluded from the "non-affiliated" group. A. 267-68.

Even for *outside* directors, otherwise independent, nondisclosure of a previous concession of control would render their proxy statement fatally misleading in reciting their approval and in urging the shareholder to accept their favorable recommendation and advice. That nondisclosure rises to a vastly different and higher level of significance, however, when all the supposedly independent directors (but one) are employees of a corporation

[2] The reality of this dependence is exemplified by the situation of Carl Sharfman, who was relieved of his duties as a TSC executive after National took control, and was then rehired in October, 1969, a few days before he was called upon to vote as a TSC director, on October 16, for the sale of all TSC assets to National. A.57.

Petitioners' attempt to characterize Mr. Schaefer as "aggressive" and, working with Noyes, as having negotiated the terms of the transaction on behalf of TSC and its shareholders. Pet. Br. 29. This assertion is irrelevant to the issue of nondisclosure here and the shareholders' right to be adequately informed of material facts.

Moreover, the assertion is not supported in the record. Schaefer had been installed as TSC's president, to serve at the pleasure of the board. A.466. Schaefer was not at either the October 2 or October 9 meeting where the terms of the deal were discussed and fixed. (Dep. of Noyes, May 12, 1970, pp. 67-69 and 134). By his own testimony, Schaefer did not know the terms of the transaction until it was presented to the TSC board at its October 16 meeting. Schaefer Dep. March 25, 1971, pp. 565-71.

which potentially stands in the hidden status of a subsidiary to the opposing party in the transaction. With that revelation, the taint runs both deeper and wider, rooted in plain self-interest, and reaching beyond the recommendation of the officers as *directors* to their advice—and the terms of the transaction they bargained for—as *management*.

5. Nondisclosure of the Key Management Positions in TSC Occupied by National Executives Was Unlawfully Misleading.

Nondisclosure of the key management positions in TSC occupied by National's principal officers operated to conceal a separate but similar conflict of interest affecting TSC's management, and the proxy statement was thereby misleading from its first page inducement: "Management urges you to vote FOR this purchase of TSC assets by National . . . ." A.259.

Who was this "management"? The shareholder was not told that Stanley Yarmuth, chief executive officer and president of National, had been installed as chairman of the board of TSC, making him TSC's chief executive officer under its by-laws, empowered to "supervise and control all of the business and affairs of the corporation." A.445, 180. The shareholder was not told that Charles Simonelli, National's Executive Vice President and a member of the Executive Committee of National's board of directors (A.305), had also assumed the chairmanship of TSC's Executive Committee, with Yarmuth as another member. That Committee was vested generally with "the powers of the Board of Directors in the management of the business and affairs of the corporation" with stated exceptions. A.467.

In short, the TSC shareholder was urged by his "management" to vote approval. But he was not told that to a substantial degree, that same management was identical with National's management, with the same persons at the same time occupying the same key offices in both corporations.[1]

To the reasonable shareholder, the clear importance of this management identity was not dependent, either in law or in common sense, upon proof of the extent to which the powers of control possessed by these dual officers were in fact exerted in the day-to-day issuance of orders. Under the official definitions incorporated by reference by both National and TSC in their reports to the SEC, "control means the *possession,* directly or indirectly, *of the power* to direct or cause the direction of the management and policies . . . ." 17 C.F.R. 240.12b-2(f); 230.405 (f). The vital fact, as a matter of law, is "possession of the power", whether or not exercised at the moment, and its importance does not flash on and off intermittently depending upon who made today's decisions. Common sense confirms the wisdom of the regulatory definition. The good subordinate does not need daily orders. He knows the side his bread is buttered upon, and exercises his delegated responsibilities in accordance with the policies and interests of his superior.[2]

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[1] Although the proxy statement describes in detail the offices and affiliations of *National's* management A.305-06, the shareholder is provided with no comparable description of his *own* management, tendering him advice, despite the requirements of Schedule 14A, Item 4(a)(1).

[2] As Yarmuth explained to the TSC board, in Schaefer's presence, Schaefer as TSC's president was "the chief *administrative* officer" (emphasis added), not the chief executive. Schaefer's testimony reflects his understanding in this regard. He was not chief executive officer of TSC. He operated the Company on a day to day basis subject to the TSC Board (which included National's top executives) and the Chairman of TSC's Board, Yarmuth. He exercised the responsibility which in his opinion had been delegated to him. A.196. He felt as if he were the chief executive and that National had exercised the same confidence in him as they would in any chief executive officer. A. 197.

A.467

Of course. Yarmuth and Simonelli could not operate all of National's subsidiaries on a day to day basis. Authority obviously had to be delegated to others, like Schaefer, to conduct the ongoing administrative supervision of these various diversified operations. A.285-286.

Conceivably, the admitted omission of these undisputed facts could have been regarded as "cumulative", as petitioners contend (Pet.Br. 31), if the proxy statement had contained a clear and unequivocal disclosure that National and TSC both had agreed in SEC reports that National may be deemed to control TSC. Without that disclosure, however, no reasonable shareholder could make an informed valuation of the recommendation urged in the name of his "management" not knowing who spoke in that name. The hand was the hand of TSC, but the voice was the voice of National.

The Court of Appeals was thus eminently correct in holding that in any event, the combined[1] nondisclosures of the SEC reports and of "the crucial positions held by National nominees Yarmuth and Simonelli on the TSC board of directors were materially misleading within the meaning of §14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 thereunder as a matter of law."

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[1] To divide and conquer, petitioners artifically separate these interrelated nondisclosures, to assert that either alone is insufficient to sustain the judgment below, but ignoring the combined effect. Pet.Br. 29, 32.

512 F.2d, 333. Nothing less would serve to "effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions." *Mills* v. *Electric Autolite Company,* 396 U.S., 385 (1970).

6. The Judgment of the Court of Appeals Was Required in Obedience to Mills v. Electric Autolite.

Six years ago this Court considered *Mills* v. *Electric Autolite Company,* 396 U.S. 375 (1970), presenting the same basic question now before the Court: Whether the shareholder-plaintiff is entitled to partial summary judgment on the issue of liability upon a documentary showing that needed shareholder votes for a corporate acquisition had been obtained through a proxy statement offering the favorable advice of the target's management without disclosing a prior report to the SEC that the acquiring corporation stood in a control relationship over the acquired corporate target. This Court unanimously held that liability is established by such a showing, and reversed the Seventh Circuit's denial, on causation grounds, of partial summary judgment for the shareholders. The Court declined to review the sufficiency of the evidence to establish a material violation, 396 U.S., 381 n.4, but Mr. Justice Harlan, for the Court, restated at length the rationale of the Seventh Circuit's conclusion that this omission was material and that the nondisclosure constituted a serious violation of law (396 U.S., 384, n.6):

> "In this case, where the misleading aspect of the solicitation involved failure to reveal a serious conflict of interest on the part of the directors, the Court of Appeals concluded that the crucial question in determining materiality was "whether the minority shareholders were sufficiently alerted to the board's relationship to their adversary to be on their guard."

> 403 F.2d, at 434. An adequate disclosure of this relationship would have warned the stockholders to give more careful scrutiny to the terms of the merger than they might to one recommended by an entirely disinterested board. Thus, the failure to make such a disclosure was found to be a material defect "as a matter of law," thwarting the informed decision at which the statute aims, regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction after more careful analysis. See also *Swanson* v. *American Consumer Industries, Inc.,* 415 F.2d 1326 (C.A. 7th Cir. 1969)."

These conclusions were the foundation for this Court's ruling that causation had been established by the materiality of the omission, and for its order of remand, directing the entry of partial summary judgment for plaintiffs. Faced with the same basic factual pattern in this case, the Seventh Circuit paid proper heed to the lesson taught by this Court in reversing *Mills.* Identity of facts requires an identical result, and the judgment below was correct under the controlling authority of *Mills.*

The controlling facts in *Mills* are directly matched by the facts here. There the acquiring corporation (Mergenthaler) had reported to the SEC that it was in a position of control over the target. Nondisclosure of this necessarily tainted the favorable recommendation of the target's board of directors, in the proxy statement addressed to their shareholders, since the directors owed their membership on the board to Mergenthaler, whether its nominees or not, and were retained because it was "considered in the best interests of Mergenthaler that they continue . . . ." *Mills* v. *Electric Autolite Company,* 403 F.2d 429, 434 (7 Cir. 1969), reversed on other grounds, 396 U.S. 375 (1970). Here control by National has been

repeatedly reported to the SEC, explained by definition as meaning that National had "power to direct . . . the management" of TSC. The advice of TSC's management and directors was thereby subject to the same taint.

7. The Proxy Statement Here Involves More Serious Violations Than the Nondisclosure in Mills.

This *Mills* minimum is enough. But the case established by the facts here is emphatically stronger, in at least five respects.

(a). Disclosure of National's Ownership of 34% of TSC's Stock Was Not a Full and Fair Disclosure of Possible Control.

The proxy statement involved in the *Mills* case disclosed that the acquiring corporation already owned 54% of the Autolite stock. To a mathematical certainty, that percentage foreclosed the possibility that control could reside anywhere else. Here the percentage owned by National was only 34%, leaving open the interpretation, as pictured in petitioners' brief, pp. 32-34, that the "old TSC management" had retained control by support from among the 66% of the shares not owned by National. With *Mills* holding that a statement of the percentage of stock owned does not excuse nondisclosure of a prior report of control to the SEC, even at 54%, it follows *a fortiori* that the proxy statement here was materially defective despite 34% disclosure. As this Court observed in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963), "what is required is 'a picture not simply of the show window, but of the entire store . . . not simply truth in the statements volunteered, but disclosure.'"

(b). The Advice of the TSC Board of Directors Was Tainted Not Only by an Undisclosed Claim of Control as in Mills, but also by the Directors' Positions as Employees.

This case is stronger than *Mills* in a second critically important aspect considered above. Here, four of the five ostensibly "non-affiliated" directors of TSC were in fact employees of TSC, who would be revealed, with disclosure of National's reported control, as beholden to National for their jobs, their promotions, and their raises in salary. They cast three of the four votes on TSC's board approving the sale of TSC's assets to National. A. 411-414.

In *Mills*, by contrast, the four directors not nominated by the acquiring corporation were all outside directors, with full-time employment elsewhere, and only two of the seven non-interlocking directors were employees of the target. Appendix, *Mills* v. *Electric Autolite Company*, No. 64, October 1969 Term, pp. 654-55, 658-65. In *Mills*, the prior report of control to the SEC was sufficient to raise "a serious conflict of interest on the part of the directors" (396 U.S., 384 n. 6), although independently employed. This is an *a fortiori* case.

(c). The SEC Reports Here, Triggered by a Change of Control, Were Material as a Matter of Law.

A still more important difference between this case and *Mills*, making nondisclosure here markedly more significant, emerges from the nature of the SEC reports filed in the two cases. In *Mills*, the acquiring corporation claimed to have been in control for a period of two or three years before the solicitation, and voluntarily filed an application for a declaration that it was exempt from the provisions of the Investment Company Act of 1940, 15

U.S.C. §80a-3. The crucial statement claiming control was submitted merely as evidence bearing on only one of the several requirements for exemption.[1] 403 F.2d, 429, 434.

Here, in contrast, the SEC reports were not volunteered but required by law, and had as their primary and dominant purpose the reporting of control. Form 8K, filed by TSC on March 7, 1969 (A.517), was required by Section 13(a) of the 1934 Act, 15 U.S.C. §78m, and Rule 13a-11, 17 C.F.R. §240.13a-11, promulgated under its authority by the SEC, to compel immediate disclosure of specified highly significant changes, occurrences, and events which have a major impact on corporate securities being traded in the markets. Among the critical events triggering such special current reports are such significant occurrences as a default in making a payment on major corporate indebtedness, withdrawal of assets securing bonds or debentures, and disposition of more than ten per cent of the corporation's total assets. Form 8-K Instructions, Items 6, 5, and 2. But the first item in this listing, assuming pre-eminent importance, is "Changes in Control of Registrant", calling for an immediate report of the name

[1] The parallel is completed here by the fact that National, too, had obtained such an exemption in 1964, on the ground that its purchases of stock in other companies, pursuant to its acquisition program, constituted not "investments" but the acquisition of "control." Continued validity of that exemption was conditioned, under the law, upon the continued existence of "the circumstances which gave rise to the issuance of an order" granting exemption. Inv.Co. Act §3(b)(2), 15 U.S.C. §80a-3(b)(2). The exemption was thus prospective, and required that future acquisitions, including the purchase of the TSC shares from Schmidt, constitute the acquisition of control. The Court of Appeals below by-passed the nondisclosure of these facts found to be fatal in *Mills*, because of the surpassing importance of the SEC reports involved here. (* Inv. Co. Rel. 4024)

of "any person who has become a parent of the registrant. . . ." Item 1(a). Form 8-K Instructions.

The important fact is thus that the 8-K report was filed as required under these provisions and not merely, as in *Mills,* the subsidiary facts recited in the report. The material fact is the filing of the report itself, not only its content.

The other reports of control by National and TSC, while not directly triggered solely by the change in control, evidence a similar emphasis upon the critical importance of this event. Schedule 13D, filed by National on February 14, 1969 (A.471), was required by the Act because National had acquired more than 10% (subsequently amended to 5%) of TSC's stock, as petitioners state. Pet.Br. 32, 34. But National was required to go further, and to disclose "any plans or proposals" it might have to liquidate or to merge TSC, or to sell its assets, *only* "(C) if the purpose of the purchases [of the Schmidt stock] is to acquire control of the business" of TSC, under §13(d)(1)(C) of the 1934 Act, 15 U.S.C. §78m(d)(1)(C). National answered Item 4 on Schedule 13D (A.490), by stating it *had* obtained control. It recited that it may be deemed a parent of TSC, and then proceeded to set forth its "plans and proposals"—information required only when the purpose of the Schmidt purchase was the acquisition of control.[1]

[1] Since the date of National's filing, Item 4 of Schedule 13D has been amended by the Commission to extend the congressional command of §13 of the Act, and to require "the purpose of the transaction to be disclosed in every Schedule 13D, regardless of an intention to acquire control . . . . See 17 CFR §240.13d-1-101 (1974)." *Rondeau* v. *Mosinee Paper Corporation,* ..... U S. ....., n. 1, 45 L.Ed. 2d 12, 17 (1975).

Form 10-K, filed by TSC on February 27, 1969 (A.509), also emphasizes the importance, in the regulatory scheme, of a change in control. The report is to be filed annually, and must disclose any parent of the reporting issuer. This item need not be answered, beyond a reference to the previous report, if there has been no change in control. However, TSC reported such a change in the same terms adopted in the other reports: National may be deemed a parent of TSC. A.512.

Congress and the Commission have thus singled out a change in control as a matter of special importance, requiring prompt action to notify the SEC. To make the information more accessible to the investing public, reports of all three kinds must also be sent to each securities exchange on which is listed any security of the controlled corporation.

These reports all are required pursuant to the provisions of §13 of the 1934 Act, 15 U.S.C. §78m. They are vital and integral parts of the overall statutory scheme, with compliance enforced by criminal sanctions. Section 14 of the Act, dealing with disclosure to shareholders when proxies are solicited, works in tandem with its adjacent Section 13, commanding interim and periodic reports of vitally important information. Any event singled out in the congressional scheme as demanding a special report under §13 must be viewed, in interpreting §14, as material in the eyes of the legislature and accordingly, as a matter of law. The report's contents, legislatively established as of surpassing importance, should be restated and revealed as material facts in a subsequent proxy statement. At minimum, a decent regard for rational consistency in the statute, read as an organic whole, demands disclosure of the fact that such reports have been made.

(d). The SEC Reports Here, Filed by the Target Corporation as Well as by the Insurgent, Carry Direct and Critical Significance.

The report of control found to be material in *Mills* was submitted solely on behalf of the acquiring corporation. Under the authority of that decision, the reported belief of the insurgent that it has control is a material fact, and nondisclosure in a proxy statement for a merger with the target is a clear violation of the proxy rules, entitling the misled shareholders to the entry of partial summary judgment on the issue of liability as a matter of law.[1] This much is established by *Mills.* And Northway's position here would be fully established if there had been no other SEC reports beyond National's Schedule 13D.

But here that ample showing is only part of the matter, and the stronger part, beyond *Mills,* lies in the fact that TSC had twice reported National's control position. A claim of control from the acquiring side of the transaction does not, in theory, exclude the argument advanced by petitioners that the target possibly may refuse to acquiesce in the status of a subsidiary. Pet.Br. 33. But here, far from refusing to acquiesce in this control status, TSC itself reported the same control relationship to the SEC.

This fact was of signal importance to the TSC shareholders. Their own adviser had recognized National's domination and the pull of divided loyalties. Once TSC's management had admitted its conflict-of-interest position, by reporting its concession that National may be the parent, the shareholder must be warned, and allowed to judge for himself, "through appropriate disclosure, . . . whether an adviser is serving 'two masters' or only one,

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[1] This was precisely the holding in *Colonial Realty Corp.* v. *Baldwin-Montrose Chemical Co.,* 312 F.Supp. 1296 (E.D. Pa. 1970), relying on this Court's opinion in *Mills.*

'especially . . . if one of the masters happens to be economic self-interest.' *United States* v. *Mississippi Valley Co.*, 364 U.S. 520, 549." *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180, 196 (1963).

(e). Reasonable Consistency in the Interpretation of Section 13 and 14 of the 1934 Act Requires That the Proxy Statement Disclose Prior Reports of a Change of Control.

This case is stronger than *Mills* in still another respect. After the proxy solicitation there, the SEC amended its proxy rules and regulations in 1966 to require explicitly the disclosure of "a change in control of the issuer [which] has occurred since the beginning of its last fiscal year . . . " This requirement was added as Item 5(e) of Schedule 14A, Information Required in Proxy Statement, and under Rule 14a-3, proxy solicitation is forbidden unless the proxy statement contains this information.[1]

It would seem reasonable, at minimum, to regard this new requirement simply as a link between Sections 13 and 14 of the 1934 Act, making explicit what is already plain from the statutory scheme: that a change in control which triggers special prompt reports under §13 should be disclosed in any subsequent proxy statement. In its practical application to the typical situation, Item 5(e) would thus ask, in effect, whether any special report of a change in control has been made in the past year.

Overlooking this modest and obvious purpose, the District Court chose instead to treat Sections 13 and 14 as wholly unrelated, uncoordinated, and inconsistent, and as authorizing defendants to "assert that National was not,

[1] Petitioner's Brief, 34, might be read as erroneously ignoring this Rule.

in fact, in control of TSC within the meaning of Item 5(e), notwithstanding the statements to the contrary in the SEC filings." Pet.A.33, 361 F.Supp. 108, 111. This remarkable and erroneous judicial stamp of approval for blatant contradiction, allowing defendants to evade the plain command of Item 5(e) by claiming their own reports were not true, became harmless in the Court of Appeals with that court's correct decision that Rule 14a-9 required disclosure of the prior reports as a matter of law.

The question of Item 5(e), however moot, serves to reveal in stark focus an unstated major premise of petitioners' whole argument here. They are asking this Court to stultify the legislative purpose and to reward dishonesty by lending its imprimatur to self-contradiction in the required disclosures under the Securities Exchange Act. Form 8-K and Item 5(e) ask precisely the same question: Has there been a change of control? Judicial approbation for opposite answers if the shoe pinches would appear to be a statement to the investing public that the special reports required by Congress have no meaning and are unworthy of any reliance or credit, since they would be freely open to contradiction and repudiation at the whim of the issuer.

Whether under Item 5(e) or the broader Rule 14a-9, a decent regard for the congressional purpose requires a rule of simple consistency in disclosures to the investor, with open avowal and explanation if repudiation of prior reports is thought to be justified. This reasonable rule serves to foster that public confidence in the securities markets which Congress sought to assure, and at the same time to promote easy and ready compliance. With prior reports at hand, the author of the proxy statement has a certain guide, and nondisclosure is necessarily a product of deliberate choice. It should not be permitted.

8. The TSC Shareholders Were Entitled by Law to Be Told What the SEC Had Been Told.

The SEC reports cannot be brushed aside as not intended to mean what they plainly say: that National controlled TSC. Form 8-K was required precisely *because* there had been a change in control,[1] and no answer to Item 4 on Schedule 13D[2] or Item 3 on Form 10-K was called for unless control was changed.[3] The question asked is half the answer, and the common recital in all three reports must be read as responsive to the question asked.

The failure to answer the same question in the proxy statement (Item 5(e), Schedule 14A) cannot be excused because the answer is only "appropriate in a required filing" with the SEC (Pet.Br. 34), and too technical for a solicitation addressed to investors as a group. As noted above, a prospectus[4] addressed to investors at large, in TSC's secondary offering made a few weeks after the SEC filings, the identical recital was set forth in the same

[1] TSC's Form 8-K report (A.517) cannot be brushed aside as merely reporting that "Schmidt's control of TSC had ceased", leaving a vacuum. Pet.Br. 32, n. 24, 34. That is simply *not* what the report said, in incorporating the statement that National had become TSC's parent. It does not even state that Schmidt formerly had control.

[2] Petitioners' brief is accurate, so far as it goes, in stating that National filed its Schedule 13D because of its stock purchase. Pet. Br. 34. *But* the answer given to Item 4 (A.490) was called for *only if* National had obtained, or intended to obtain, control. See p. 55, *supra*.

[3] TSC's Form 10-K report (A.519) required no answer to Item 3, concerning the "parent" of TSC, unless there had been a change since previous reports.

[4] Pl. Ex. 106, p. 21. This prospectus was required to disclose any "parent" of the issuer. See Form S-1, Item 8, 17 C.F.R. §230.

words, "National may be deemed to be a 'parent' of TSC as that term is defined in the rules and regulations under the Securities Act of 1933." Apparently the recital is "inappropriate" (Pet.Br. 34) only when its disclosure would reveal the inherent conflict of interest and threaten the success of the self-dealing transaction, that is, when the recipient is a shareholder who really needs to know.[1]

The recital was *not* compelled, of course, merely because National had acquired one third of TSC's stock. The reports could not be based "solely" on that acquisition (Pet.Br. 32, 33) since they would be unlawful if, in accordance with the picture painted by petitioners' brief, and by the proxy statement, the "non-affiliated" directors had chosen not to surrender, but had resisted, creating a stand-off on the equally divided board depriving National of control while the holders of the other two-thirds of the stock were rallied in a proxy contest. If that had been the true situation, or if for other reasons either National or TSC had believed that control was in doubt or was only a "possibility" (Pet.Br. 32 n. 24), they were specifically directed by the official instructions to say so.[2] But however control was reported to the SEC and to the stock exchanges, with whatever doubts or hedges, the shareholders were entitled to be told the same story.

[1] This prospectus "risked confusing shareholders" (Pet. Br. 33) at no risk to National's interest, apparently, since an outside purchaser of the new issue of TSC stock was not threatened in his decision by any conflict of interest produced by National's control.

[2] Rule 12b-22, applicable to all three reports, provides: "If the existence of control is open to reasonable doubt in any instance, the registrant may disclaim the existence of control and any admission thereof; in such case, however, the registrant shall state the material facts pertinent to the possible existence of control." 17 CFR §240.12b-22.

II.

THE ADMITTED NONDISCLOSURES VIOLATE THE PROXY RULES AS A MATTER OF LAW UNDER ANY REASONABLE TEST OF MATERIALITY.

The petition for certiorari tendered to this Court a broad and far-reaching question of the proper definition of materiality under the federal securities laws. Pet. 7. Against the compelling force of the admitted and uncontroverted facts, however, any minor refinements in the words employed to define materiality could have no effect on the result of this case. Petitioners' brief on the merits fails to demonstrate how substitution of "would" or an emphasis on "propensity" in this Court's definition laid down in *Mills,* 396 U.S. 375, 384 (1970), and reconfirmed in *Ute,* 406 U.S. 128, 154 (1972), could require reversal. The two major parts of that brief remain utterly unrelated, and there is no foundation nor justification in the factual record for nice refinements in the test of materiality which might produce a reversal punitive to respondent because of the Court of Appeals' adherence to this Court's announced test.

A.

THE PURPOSES AND POLICIES OF THE SECURITIES LAWS IMPOSE THE MOST RIGOROUS DUTY OF FULL AND FAIR DISCLOSURE IN A MANAGEMENT PROXY STATEMENT URGING APPROVAL OF A TRANSACTION FOR THE BENEFIT OF THE PRINCIPAL STOCKHOLDER.

To accept petitioners' arguments here, and to rule that these admitted half truths violate no provision of the securities laws, would emasculate a fundamental congressional policy, strengthened and reconfirmed in its forty-

year span. Protection of investors against predatory practices is both an end in itself and a vital means of ensuring the nation's economic health by nurturing the investor confidence which is essential to "the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes. . . ." *United Housing Foundation, Inc.* v. *Forman,* U.S. (1975) [95 S.Ct. 2051, 2059]. This case lies at the very heart of the basic policy, and the proxy statement here is the prototype of that "deceptive or inadequate disclosure in proxy solicitation" which Congress condemned. *J.I. Case Co.* v. *Borak,* 377 U.S. 426, 431 (1964).

1. Whatever the Proper Test of Materiality for Other Forms of Transactions, the Circumstances of These Admitted Nondisclosures Call For the Most Inclusive Standard of Materiality.

There is no quarrel with petitioners' starting point: that "full and fair disclosure of material information [is] a guiding principle" of the 1933 and 1934 Acts. Pet. Br. 18. And it is equally common ground that "materiality is the key to disclosure standards." Pet. Br. 18.

But agreement does not extend to the next step in their argument, implying that one monolithic standard of disclosure and one uniform test of materiality must be applied across the board to all the varied forms of securities transactions, between participants in all possible relationships, to all forms of communications, and under all the varied provisions of the acts and rules requiring disclosure of material information. Petitioners seem to suppose that one unvarying test must be laid down for actions under "Sections 11, 12(2) and 17 of the Securities Act and Sections 10, 14 and 18 of the 1934 Act" and "under Rule 10b-5" and "Section 14(e) of the 1934 Act."

Pet. Br. 19, 26; Pet. 7. They illustrate their proposed "uniform" standard of materiality with three examples, all extreme cases where the information was so extraordinary that a press release was immediately required to alert the investing public at large. Pet. Br. 26-27 n. 21. Of course no such question is presented in this case, there is no need to consider whether the information withheld from the proxy statement should have been broadcast at once to the world at large.

Here the Court has before it a proxy statement jointly issued by the acquiring and target corporate management urging approval of a major proposal without disclosing certain admitted facts. This Court is not called upon here to decide every possible case that may involve some question of disclosure or an issue of materiality. It is enough for decision here to note, as lower courts and commentators have observed,[1] that different considerations may call for differing standards in other cases. Such cases may range from the press release demanded to inform the trading market generally of extraordinary developments, at one extreme, to the management proxy statement, at the other extreme. Various factors, responsive to the legislative purpose, appear relevant to the proxy statement standard of materiality enunciated by this Court in *Mills*. These factors include the following:

(a). *Full-story documents.* A proxy statement is a full story document. The issuer is directed by law to furnish a written document to tell the full story as a self-contained source of all relevant information.

[1] See Ruder, *Factors Determining the Degree of Culpability Necessary for Violation of the Federal Securities Laws in Information Transmission Cases,* 32 Wash. & Lee L. Rev. 571 (1975); *ALI Fed. Securities Code,* pp. xix, xvii (March, 1973 Draft).

It has a statutory duty to speak in any event, and is forbidden to solicit proxies without a full proxy statement. The command is not simply "tell no lies"; it is rather "tell the whole truth."[1]

(b). *The Sales-talk.* Relevant also is the fact that the joint proxy statement here was written to induce the reader to enter into a transaction for the defendant's own benefit and profit.[2] When the very purpose of the document is to persuade and to influence action, the law may fairly hold the issuer to his avowed objective, and accept his sales talks as tending to accomplish its intended purpose: to sway the reasonable investor.[3]

(c). *Half truth.* It is also important to recognize the circumstances where the issuer has broached a subject and focused attention on it by furnishing a part of the facts—half the truth. Omitted facts con-

[1] Congress requires "not simply truth in the statements volunteered, but disclosure." *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 201 (1963).

[2] The legislative history on salesmanship is reviewed in *Blue Chip Stamps* v. *Manor Drug Stores,* U.S. [44 L Ed 539, 559] (1975). This Court there quotes the House Report on the subject:

> "Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction states one of the best arguments for the provision." H.R.Rep. No. 85, 73d Cong., 1st Sess. 8 (1933).

[3] In Mr. Justice Cardozo's phrase, "The springs of conduct are subtle and varied. One who meddles with them must not insist upon too nice a measure of proof that the spring which he released was effective to the exclusion of all others." *DeCicco* v. *Schweizer,* 221 N.Y. 431, 438, 117 N.E. 807, 810 (1917).

cerning the same subject matter then assume an inevitable importance—an importance which the issuer has himself created. As here, having chosen to reveal half the facts, the issuer is in no position to contest the materiality of the remainder, nor to claim in mitigation its belief that none of the story was relevant.

(d). *Fiduciary relationships.* In an arms-length transaction between strangers, a duty of disclosure may be imposed when a disparity of knowledge results from one party's status as an insider.[1] But a more stringent duty of disclosure, and a more pervasive standard of materiality, obtains where, as here, key officials of a defendant occupy in addition the status of fiduciaries because of their positions as corporate directors and high management of the target firm. Where such fiduciary relationships exist a defendant is specially charged to make full disclosure. This is particularly true with respect to facts which have an important bearing on potential conflict of interest and independence in urging the target's shareholders to accept the proposal.

(e). *Corporate suffrage.* The proxy statement is corporate suffrage in action. The congressional purpose is to protect "fair corporate suffrage" and to prevent abuses which "frustrated the free exercise of the voting rights of stockholders." *J.I. Case Co.* v. *Borak,* 377 U.S. 426, 431 (1964).

The proxy statute and rules seek to guarantee the shareholder's right to vote as his judgment directs. Here the

[1] See *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972).

substantive merits of the offer are not controlling: the shareholders have the right to reject an advantageous exchange if they prefer the status quo, or to accept an unwise exchange if they choose. The standard of materiality should be broad enough to permit them to exercise their statutory franchise fully and reasonably.

Where, as here, the shareholder confronts an electoral process to decide whether he will become an equity holder in a different and unfamiliar corporation, full disclosure is required for all aspects of the transaction which a shareholder, in reason, might consider important in casting his ballot.[1] The joint proxy statement here invited the TSC shareholder not merely to buy and sell, but also to *vote.*[2]

(f). *Regulatory facts.* Facts singled out by Congress and the Commission carry special importance in the regulatory scheme. They must be viewed, in deference to the legislative purpose and administrative expertise, as material by virtue of the act and regulations—as a matter of law. Here the nondisclosures concern factors which have been singled out by law for special attention, regulation, and disclosure: control, market values, and market activities by the issuer and its affiliates.

[1] See SEC Securities Act Release Nos. 33-5627, 34-11733, Environmental and Social Disclosure, 40 Fed.Reg. 51656, at 51659 (Nov. 6, 1975).

[2] The dilemma confronted by the shareholder who receives a tender offer is accentuated when the communication is a merger proxy statement, putting him under the gun. For a description of the predicament, see *Rondeau* v. *Mosinee Paper Corp.,* U.S. [45 L Ed 2d 12, 20 n.8] (1975).

These matters reach to the heart of the traditional economic concerns of the securities laws, and stand in marked contrast to "environmental and other matters of social concern, including equal employment matters • • • [and] the promotion of social goals unrelated to the objectives of the federal securities laws." SEC Securities Act Releases Nos. 33-5627, 34-11733, Environmental and Social Disclosure, 40 Fed.Reg. 51656 (Nov. 6, 1975). This release explains the Commission's reluctance "to require disclosure for the sole purpose of promoting social goals unrelated to those underlying these Acts" (40 Fed. Reg., 51660). It is borrowed from its context by petitioners to furnish "a significant portion of the text" of petitioners' brief although the release plainly is devoted to such extraneous matters. Pet. Br. 18 n. 5.

In sum, here the several purposes and policies ~~coverage~~ Coverage to exact the fullest disclosure. Defendants are "the most inside of insiders",[1] and "the insider par excellence."[2] Here the proxy statement is a selling document, seeking votes on behalf of TSC's management and for the benefit of its principal stockholder (National), jointly issued to urge approval of the self-dealing sale of TSC's assets to National. Bound to tell the full story, they offer instead half truths touching the most vital factors influencing the shareholders' votes—factors emphasized by Congress and the Commission as of critical materiality. Petitioners necessarily concede that "in many cases misstatements or omissions may be so clearly material that there is no

[1] 1 Bromberg, *Securities Law: Fraud* §6.4(1) (1967).

[2] Professor Stanley Kaplan, statement in Hearings on S.510 before the Subcomm. on Banking and Currency, 90th Cong., 1st Sess., 132 (1967), quoted in *Broder* v. *Dane*, 384 F. Supp. 1312, 1319 (S.D.N.Y. 1974).

need nor occasion to focus on the standard of materiality." Pet. 10. If nondisclosures can ever be ruled to be material as a matter of law in a proper case, then this is that case.

2. The Court of Appeals Properly Adjudicated Petitioners' Violations of the Proxy Laws, and Their Consequent Liability for Appropriate Derivative Relief.

The Court of Appeals here has done no more than to declare the conclusion compelled by matching the admitted facts against the controlling law, read in light of its spirit: that the joint proxy statement violates the prohibition against misleading proxy solicitation. This judicial conclusion received strong support in the court below from the SEC as the agency of government most expert in the practicalities of achieving the legislative purpose and most sensitive to the underlying policies.

As this Court has noted, Congress has left it to the SEC to decide whether these policies "should be effected by rulemaking or by *ad hoc* adjudicatory actions . . . ." *SEC* v. *Chenery Corp.*, 332 U.S. 194, 209 (1947), "Private enforcement of the proxy rules provides a necessary supplement to Commission action . . . . serves as a most effective weapon to the enforcement of the proxy requirements." *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 428, 432 (1964). With limited staff and resources for investigating and litigating, the Commission has chosen here to seek enforcement of the policies for which it is primarily responsible by asserting its authoritative position at the appellate level in litigation privately initiated. That position is entitled to full deference.

Congress, the courts, and the Commission have joined to forbid the inference which petitioners seek to draw from their recital that the SEC staff "took no exception whatever to any of the alleged defects," (Pet. Br. 28-29,

Pet. Reply Br. in Support of Petition 8-9), when a draft of the proxy statement was examined. By §26 of the 1934 Act, Congress directly forbids such an inference: "No . . . failure to act by the Commission . . . with regard to any statement . . . filed with or examined by such authority . . . [shall] be deemed a finding by such authority that such statement . . . is not false or misleading." Securities Exchange Act of 1934, §26, 15 U.S.C. §78z. The Commission has tailored this statutory prohibition to apply specifically to proxy statements. (R. 14a-9(b)).

The reasons are obvious enough. The SEC receives more than twenty voluminous drafts of such statements every working day. An immense staff would be required to conduct a thorough field investigation in sufficient depth to discover, for example, the Madison-National relationships and purchases, or the full Noyes' opinion, neither discoverable from the filing. Of necessity, the staff's examination and review is confined to the four corners of the draft submitted, as the staff's letter of suggestions demonstrates by its content. A. 96-100.

Nor can the limited staff be charged, at this volume, with a duty to scour the Commission files for omitted facts, such as the SEC reports here, filed some eight months earlier. That point was also important in *Mills*, 396 U.S. 375 (1970), where the omission at issue was the failure to disclose facts in the Commission's files.

More importantly, the Commission itself, as distinguished from its staff, has no time to examine all such drafts nor to conduct appellate review of its staff's correspondence. The Commission is not "singing more than one song." Pet. Reply Br. in Support of Pet. 8. The Commission itself *does* decide on every position taken in its name in any litigation.

Nor can the blatant nondisclosures be passed off as mere technical oversights, inevitable slips in a good faith effort to comply. Petitioners' faint protestations in this record are equally irrelevant and unsupportable.[1]

Moreover, National was no novice in this regulatory field. In the five years preceding this deal, National had put through some twenty-five large scale corporate acquisitions. A. 285. With this know-how, their implied resort to the cover of "reputable attorneys" (Pet. Br. 28) is of no aid.

Nothing is before the Court at this time beyond the adjudication of the defendants' violation of the proxy rules, and their consequent liability. That liability involves no *in terrorem* element of threatened damages in an indeterminate amount for an undefinable, unlimited, or unforeseeable class of plaintiffs. See *Blue Chip Stamps* v. *Manor Drug Stores*, U.S. [44 L Ed 2d 539, 556] (1975). Here the action is derivative, maintained on behalf of TSC and, in practicality, for the benefit of the so-called minority who relinquished 66% of its stock, a limited, well-defined and ascertained group. The issue of appropriate relief has yet to be litigated or decided, and will be governed by traditional principles determining proper remedies. See *Rondeau* v. *Mosinee Paper Corp.*, U.S. [45 L Ed 2d 12, 23-24] (1975).

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[1] In fashioning an express civil remedy for the communication most closely analogous to the proxy statement, Congress has provided that, in an action for misleading omissions in a registration statement under the 1933 Act, good faith and due diligence are not defenses available to the corporate issuer. Securities Act of 1933, §11(b), 15 U.S.C. §77k(b) (1933). The courts apply a parallel rule under §14 of the 1934 Act. Lower court decisions are collected in Annotation, 24 ALR Fed. 241 (1975).

Here the transaction was in substance, although not in form, a corporate merger, with the former TSC shareholders becoming National holders. Plaintiffs claim derivatively that the National securities received in exchange for TSC's assets were grossly insufficient. That disparity was at the same time the TSC shareholders' loss and National's gain. In such a case, an award of damages, if appropriate, involves no potential of a ruinous or indeterminate liability to outsiders. The question is simply the fair division of the corporate pie among the family of its own security holders.

B.

THE PROPER STANDARD OF MATERIALITY WAS CORRECTLY APPLIED BY THE COURT OF APPEALS.

The petition for certiorari in this case offered a supposedly basic and unsettled question of the standard and definition of materiality under the proxy rules applicable here. That supposed question fades into insignificance in the glaring light of the proxy statement's naked half-truths on critical matters of the most vital interest to the shareholders. As respondent argued in its Brief in Opposition to the Petition 6-13, these admitted nondisclosures are of surpassing importance, beyond the reach of any minor differences in the range of varied definitions of materiality that have been employed. Under any plausible standard that might be adopted, the omissions are material as a matter of law. Accordingly, respondents have no objection to any reasonable phrasing of the standard that may be advanced by petitioners, so long as elements of reliance or causation are not thereby smuggled into the case in violation of this Court's holding in *Mills* v. *Electric Autolite,* 396 U.S. 375 (1970).

1. The Standard of Materiality Applicable to This Proxy Statement Was Clearly Laid Down by the Court in Mills v. Electric Autolite.

This Court does not write on a clean slate in considering, to whatever extent necessary in this case, the proper test of materiality. Both parties in this suit are agreed that the controlling authority on the question, as recognized by the Seventh Circuit, is to be found in this Court's opinion in *Mills* v. *Electric Autolite Co.,* 396 U.S. 375, 384 (1970), and in the subsequent reiteration and confirmation of that test in *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 154 (1972).

The Court of Appeals adhered faithfully to that binding authority, and quoted and applied its language: "whether the omitted fact is 'of such a character that it might have been considered important by a reasonable shareholder who was in the process of determining how to vote.'" 512 F.2d 324, 332. In doing so, the Seventh Circuit rejected the assertion that this Court had not meant what it plainly said, and properly declined to arrogate to itself the power to amend this Court's formulation by substituting "would" for "might", or by adding a second and additional requirement of a showing that the omission, in probability, affected the actual result of the vote. Neither amendment would comport with the careful craftsmanship of Mr. Justice Harlan's opinion, for a unanimous Court, in *Mills.* He used the sign "cf." to signal the difference between his announced test, using "might", and the lower court decisions and secondary authorities which had stated the test in terms of "would". 396 U.S. 384 n. 6. The word choice was deliberate and

purposeful, not inadvertent.[1] Mr. Justice Blackmun, writing for the Court in *Ute,* 406 U.S. 128, 154, followed this formulation and employed the same words to state the test of materiality, reversing the Tenth Circuit which had held that disclosure of the omitted facts was not required. 431 F.2d, at 1347.

This deliberate choice of words cannot be disregarded by the lower courts as mere dictum.[2] The Court in *Mills* was addressing the question before it: what must be established in order to complete a case of liability for misleading proxy solicitation. Materiality is an essential element of the cause of action, and the definition was an essential predicate of this Court's judgment, reversing the Seventh Circuit and directing the entry of summary judgment for plaintiffs on the issue of liability.

The Court chose in its discretion not to review the factual basis for the lower court's finding of materiality, to scour the record to assess the sufficiency of the evidence to establish the truth of the omitted facts. 396 U.S., 381 n.4. But the question of law, of the proper test of

[1] The court in *Smallwood* v. *Pearl Brewing Co.,* 489 F.2d 579, 604 (5 Cir. 1974), cert. denied 419 U.S. 873 (1974), heavily relied upon by Petitioners' Brief, 25, appears to impute this Court's deliberate choice of words to mere carelessness. A more charitable reading of that opinion would suggest that the Court meant only that the difference was insignificant, and use of either would be harmless error. *Cf. Cohen* v. *Franchard,* 478 F.2d 115, 124 (2 Cir. 1973).

[2] It is apparently on this erroneous ground of *dictum* that the Second Circuit felt at at liberty to reject *Mills* and to rule that "the 'might have been' standard mentioned by Mr. Justice Harlan sets somewhat too low a threshold. . . ." *Gerstle* v. *Gamble-Skogmo,* 478 F.2d 1281, 1302 (2 Cir. 1973).

materiality and of the "conclusion it embodies" (396 U.S., 384), was indispensable to the ultimate judgment, "that petitioners have established their case by showing that proxies necessary to approval of the merger were obtained by means of a materially misleading proxy solicitation. . . ." 396 U.S., 386.

In sum, the decision enumerates the elements of the case and provides an equation: liability is established when "proxies necessary to approval were obtained by means of a proxy" involving a "misstatement or omission . . . of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." 396 U.S., 384. This minimum is sufficient; no more is required to be established.

The Court has recently reaffirmed the authority of the *Mills* decision as a complete and self-contained enumeration and definition of the elements necessary to establish liability:

> "There we held that complaining shareholders had proven their case under §14(a) of the 1934 Act by showing that misleading statements in a proxy solicitation were material and that the solicitation itself 'was an essential link in the accomplishment of' a merger. We concluded that any stricter standard would frustrate private enforcement of the proxy rules. . . ." *Rondeau* v. *Mosinee Paper Corp.,* U.S [45 L Ed 2d 12, 24] (1975).

In the teeth of these decisions, it is insupportable to assert that "this Court has not heretofore considered directly a standard or definition of materiality under the securities laws" or that the "Seventh Circuit adopted [a] new 'might' test". Pet.Br. 17. It is petitioners, not

the Seventh Circuit, who have failed to heed the authority of this Court's decisions.

2. The Basic Issue of Materiality, However the Test May be Phrased, Is Whether the Matter Is Important Enough, in Light of the Legislative Purpose, that Shareholders Ought to be Informed.

The difference between "might" and "would", in asking whether a fact carries importance in the consideration of the reasonable shareholder, may be called "gossamer", as both the Second and Seventh Circuit (in supposed conflict warranting certiorari) have noted.[1] Petitioners have commendably withdrawn from that grammarian conflict in their brief on the merits, advancing a test that uses neither the future perfect nor the future perfect conditional form of the verb, but says simply that materiality means "such information *as is* important to the reasonable investor . . . ." Pet. Br. 16 (emphasis added).

The lower courts have frequently concluded that the choice between "might" and "would" is indifferent to the outcome of a concrete case; the same result is reached with either word.[2] Other courts have demonstrated the insignificance of the choice by using the terms interchangeably, without mention of any possible difference.[3] Even

[1] Opinion below, 512 F.2d 324, 331 n. 13; *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1302 (2 Cir. 1974).

[2] See, *e.g.*, *Ash* v. *Baker*, 392 F.Supp. 368, 371-72 (E.D. Pa. 1975); *Lewis* v. *Marine Midland Grace Trust Co.*, 63 F.R.D. 39, 43 (S.D.N.Y. 1973); *Harnett* v. *Ryan Homes, Inc.*, 496 F.2d 832, 838 (3 Cir. 1974) (cited in Petitioners' Brief 26 for the "would" test). See also *Broder* v. *Dane*, 384 F.Supp. 1312,1320-21 (S.D.N.Y. 1974) (doubting whether "a verbal formula is useful").

[3] See, *e.g.*, *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 363, 374 (2 Cir. 1973), cert. denied 414 U.S. 910 (1973).

in the Circuits where the Courts of Appeals have consciously chosen to reject *Mills* and *Ute* and to employ "would", subsequent opinions have ignored the distinction and followed the "might" language dictated by this Court.[1]

The precise phrasing of the definition of materiality need not be graven in stone. In the flexibility of language, a variety of formulations have been used without difficulty by the courts to express the basically simple idea.[2] Respondent has no quarrel with "might", "would", or petitioners' "as is", since under any possible definition within the realm of reason, the omitted facts in this case are plainly material.

What is vital, however, beyond any niceties of phrasing, is the necessity for a keen awareness of the fact that the definition of materiality is purposeful, not an empty dictionary exercise. The test, however phrased, must be applied to achieve the underlying statutory purpose: to give investors the information, fully and fairly, which they ought to have in order to reach in-

[1] After *Gerstle*, using "would", the same Circuit adhered to "might" in *Sonesta Int'l. Hotel Corp.* v. *Wellington Associates*, 483 F.2d 247, 252 (2 Cir. 1973); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith*, 495 F.2d 228, 239 (2 Cir. 1974); *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2 Cir. 1974). After *Smallwood*, using "would", the same Circuit adhered to "might" in ~~*Simon v. Merrill Lynch, Pierce, Fenner & Smith*, 482 F.2d 880 (5 Cir. 1973)~~; ~~and~~ *Sargent* v. *Genesco*, 492 F.2d 750 (5 Cir. 1974).

[2] See, *e.g.*, *Kohler* v. *Kohler Co.*, 319 F.2d 634, 642 (7 Cir. 1963) (facts are material which in reasonable and objective contemplation might affect the value of the corporation's stock); *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 362-63 (2 Cir. 1973), cert. denied 414 U.S. 910 (1973) (using the concept of "weightiness" as the test of materiality).

telligent, informed, and well-advised decisions. To keep the legislative purpose in the forefront, a more effective definition has been adopted by the SEC, committed to that purpose: "material" information means "matters as to which an average prudent investor ought reasonably to be informed before making his decision." Rule 405(1), 17 CFR §230.405(1) (under the 1933 Act).

3. This Court in Mills Rejected the Probability of a Different Vote as a Test of Materiality or Liability under the Proxy Rules.

Petitioners apparently charge the Seventh Circuit with error in failing to add to the test of materiality a requirement of proof of a "real probability [that] an omitted fact would affect a voting (or investment) decision." Pet. Br. 25 n. 17. In this position, they are asking, albeit guardedly, nothing less than the overruling of *Mills*, where the Court expressly rejected any such requirement.

The argument was more openly presented by the original petition, where they avowedly sought "a trial on the issue of materiality" requiring a finding "that the omission or misstatement is likely to alter the outcome of shareholder voting." Pet. 16, 13. In their brief on the merits, the argument is made only inferentially, that a trial must be held to determine whether the TSC shareholders would still have approved the merger if the proxy statement had been truthful.

Petitioners' argument here runs along this line: Because probability has been eliminated as an element of causation by *Mills*, that same probability should be reintroduced as an element of materiality. Pet. Br. 16-17, 24-25 n. 17. This striking non-sequitur would impute to the Court in *Mills* a plot to take with the left what it

gave with the right. It would play a game of labels, requiring proof of a "real probability" of an opposite outcome of the vote under the label of materiality rather than causation. Under this view, the decision in *Mills* was no more than a verbal trick.

The *Mills* decision will not support such a vacuous interpretation. The sentence immediately following the paragraph defining "this requirement" of materiality proceeds: "There is no need to supplement this requirement, as did the Court of Appeals with a requirement of proof of whether the defect actually had a decisive effect on the voting." 396 U.S. 384. Recognizing "the impracticalities of determining how many votes were affected", this Court concluded that "reliance by thousands of individuals, as here, can scarcely be inquired into . . . ." 396 U.S. 385, 380. Whether under the label of materiality, causation, or reliance, *Mills* stands as irrefutable authority against any requirement of a showing that the vote was in fact affected by the defect in the proxy statement.

Eschewing a direct adjudication of that issue, the Court of Appeals in *Mills* had fallen back to an objective approach to the effect on the outcome of the vote, looking not to actualities but to the "probabilities that the merger would have received a sufficient vote even if the proxy statement had not been misleading." 396 U.S., 380. The denial of summary judgment without a finding of those "probabilities" was the precise issue presented to this Court in *Mills*, and the reversal directly rejected any requirement of such a probability. Here petitioners are offering, at most, that same rejected claim in a slightly altered guise, insisting that there must be a finding of "a real probability" or "a strong likelihood" of the defect "to affect the shareholder/investor's decisions" and

to lead "'a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course.'" Pet. Br. 24, 25, 27.

Even assuming that petitioners here refer to a hypothetical reasonable shareholder, rather than to the actual shareholders who voted, they are simply repeating, in different words, the position directly rejected in *Mills*: that the effect must be such as to make it probable that the reasonable shareholder would have changed his vote, taking into account the other information supplied including the attractiveness and fairness of the offer. There is no requirement that the nondisclosure must be determinative of the reasonable shareholder's vote. Describing the lower court's decision in *Mills*, this Court observed:

> "Thus, the failure to make such a disclosure was found to be a material defect 'as a matter of law,' thwarting the informed decision at which the statute aims, *regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction* after more careful analysis." 396 U.S., 384 n. 6. (Emphasis added)

Congress has not confined the shareholders to the rights that would be claimed by a rational, purely economic man. "There is no justification for presuming that the shareholders of every corporation are willing to accept any and every fair merger offer put before them." 396 U.S., 382 n. 5. On the contrary, they are guaranteed the right to weigh "the many other factors that might lead shareholders to prefer their current position to that of owners of a larger, combined enterprise. . . ." 396 U.S., 382. n. 5. To rule that a nondisclosure is not material when it is "too insignificant" (Pet. Br. 25 n.

17) to alter the reasonable shareholder's vote "would allow the stockholders to be bypassed . . . . A judicial appraisal of the merger's merits could be substituted for the actual and informed vote of the stockholders." 396 U.S., 381.

In short, the reasons which led this Court in *Mills* to reject proof of probability of an effect on the outcome of the vote as a prerequisite to liability were not confined to any question of causation. They are rooted in the legislative purpose, and apply as well to the same proof of probability advanced as a test of materiality.

4. Under Mills, Propensity to Affect the Voting Process Is Inherent in the Conclusion that a Reasonable Shareholder Might Consider the Omitted Fact to Be Important.

The Court in *Mills* did not contradict itself, and require a finding of a probable change in outcome of the vote, directly or indirectly, by using the phrase "significant propensity to affect the voting process." That phrase, which forms the foundation for petitioners' whole argument on materiality, does not lay down a conflicting, supplemental, or different standard. It is rather a characterization of the inherent tendency or inclination implicit in the test of materiality which immediately precedes it. In context, the opinion states that materiality

> "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote. This requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to

> the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a)." 396 U.S. 384

This passage was directly addressed to the issue before the Court: What effect on the voting process must be shown to establish liability for omissions or misstatements in a proxy statement? The answer is plain. The "significant propensity" is established when the defect "might have been considered important by a reasonable shareholder." No further inquiry is required into the probability of a different outcome of the voting process. The requisite propensity inheres in the conclusion that the nondisclosure might reasonably have been considered important. For this obvious reason, this Court in *Ute*, 406 U.S., 154, made no mention of propensity at all.

5. The Opinion of the Court of Appeals Properly Applies the Holding of Mills.

Fairly read, the opinion of the Court of Appeals in this case does no more than restate these principles. The author of that opinion had served as a member of the panel of the Seventh Circuit which had been reversed in *Mills* for ordering a trial of the probabilities that the defect affected the voting process. Once burned, twice shy, the writer was reacting adversely to the same arguments which had brought reversal before. He was rejecting the claim that trial must be held with "a finding of some probability that the omitted fact would affect the voting process" because of the difficulty of proof. 512 F.2d, 331. He was rejecting not the significant propensity which inheres in the conclusion that the defect might have been considered important by a reasonable shareholder, but rather a distorted and discredited "propensity" converted to a "probability", which would require "some evidence, direct or indirect, tending to show that the challenged omission had an actual impact in his case." 512 F.2d 331 n. 13.

For the same reasons, the Court of Appeals was leery of any "would" test of materiality as implying the need for a trial, and in common sense saw no difference "in the trial context, between proofs which show that a particular omission would have been relied on, and those which show that the omission was in fact relied on . . . ." 512 F.2d, 331 n. 13. It was *not* saying that no "significant propensity" is required, but rather correctly "recognized that the concept of materiality is itself defined in terms of potential causative effects" (512 F.2d, 329), and was adhering to this Court's direction that no showing of propensity can be required beyond the propensity inherent in the conclusion that a reasonable shareholder might have considered the nondisclosure to be important.

Thus the words "propensity", "might", or "would" do not describe a factual burden of proving what would or did actually happen. The question to be decided is the logical force of the information within the processes of ordinary reason common to average, prudent investors.

The Court of Appeals thus correctly concluded, in obedience to this Court's command, that materiality must be measured not along the scale of degrees of factual probability, but along the scale of degrees of relevancy or logical weight. Thus "relevancy alone is the critical test of materiality" without proof of probable reliance or causation. 512 F.2d, 331 n.13. Along this scale of relevancy, it is necessary that the omitted fact is of such a character as to be *important* to the *reasonable*

shareholder, not trivial or unrelated to the transaction, as the opinion below correctly recognizes and emphasizes. 512 F.2d, 331, 332, Pet. A. 9-12.

The opinion rules that nondisclosure of the extraordinary fact that only a minority of the TSC board voted for the transaction was not "*clearly* relevant" (emphasis added), and was not therefore material as a matter of law. 512 F.2d, 338. While respondent believes that the fact was of such a character as to be of considerable importance to the reasonable shareholder, urged on by the ostensible advice of his board, and that the Court of Appeals erred in this restrictive ruling, the decision on this point plainly refutes any notion that the lower court was adopting some flat, Draconian rule under which any barely relevant fact would have to be included.[1] Pet.Br. 23. Any possible implication to the contrary that might be drawn from the concluding sentence of footnote 13, 512 F.2d, 331, is foreclosed by this ruling. In any event, this Court does not sit to reverse lower court footnotes.

The Court of Appeals in this case made a scrupulous effort to abide by this Court's teachings. It reached the right result, and entered the proper judgment. If some language in the opinion were thought to be overbroad, that verbal fault would not justify reversal, and could be readily corrected by this Court's opinion.

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[1] The first Question Presented, Pet. Br. 3, is not an accurate characterization of the opinion below in this respect. It is also inaccurate in stating that the Seventh Circuit held that "possible importance to 'some few stockholders'" would suffice. The court below was rather speaking of facts which would be "determinative" for some few stockholders, although not for all. 512 F.2d, 330.

If, moreover, some new and different test of materiality were now to be announced by this Court, as petitioners contend, this Court is as well situated as the Court of Appeals to apply such a test to the uncontroverted facts. To reverse for reconsideration in light of such a new, refined, or altered test of materiality, visiting the costs of this appeal upon respondent would be a step backward from the salutary principle of *Mills* that the expenses of litigation in the corporation's behalf establishing a violation of the securities laws should be shared by that corporation and its shareholders. 396 U.S., 389-395.

6. Petitioners' Violations Were Properly Adjudicated as a Matter of Law, and Summary Judgment Was Correctly Entered by the Court of Appeals.

Once it is plainly understood that materiality under *Mills* involves no issue of factual probability of any actual past or future occurrence, the question whether a reasonable shareholder might have considered the omitted fact to be important is revealed as only a useful metaphor employing a hypothetical person in an abstract situation, knowing what had been concealed. The issue is not prediction, but whether, in light of the underlying statutory purpose, the shareholder ought to be informed before casting his vote.

When the omission is established by the content of the proxy statement, and the external facts not disclosed are conclusively established by documentary evidence, there remains no issue of fact to be litigated. In this case, the resolution of whether a violation has been established turns upon the interpretation of the governing statute and rules, construed in the light of the regulatory scheme as a whole, the interrelationships among its

various regulations, the legislative history, and the guidance provided by judicial precedent and by authoritative interpretations by the administrative body with expertise and responsibility in the area.

Whether the law imposes a duty of disclosure under these admitted circumstances, that is, the question of materiality, is thus a matter of law. It is a question of what the law requires, for the judge to decide, not a question of fact to be resolved upon evidence at a trial with a jury or judge as trier of fact. A determination of materiality in this case does not involve "findings of fact" but rather "application of legal standards"[1] a question of law. Cf. *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 364 (2d Cir. 1973), cert. denied 414 U.S. 910 (1973).

Upon any reasonable standard of materiality this case was clearly appropriate for summary judgment on the issue of liability. Such judgments are commonplace.[1] This Court's decision in Mills itself refutes any notion that summary judgment could never be granted in plaintiff's favor, based on a ruling that the proxy statement violates the proxy rules as a matter of law. This Court specifically directed the entry of such a judgment. 396 U.S., 383. There was certainly no "misuse" of summary judgment to petitioners' prejudice. Pet.Br. 3.

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[1] Plaintiffs' summary judgments were granted or affirmed, by way of example, in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1972), and *John Hopkins University* v. *Hutton*, 422 F.2d 1124 (4th Cir. 1970), both relied upon in Petitioners' Brief, as well as in *Beatty* v. *Bright*, 318 F.Supp. 169 (S.D. Iowa 1970), *Berman* v. *Thomson*, 312 F.Supp. 1031 (N.D. Ill. 1970), and *Gould* v. *American Hawaiian S.S. Co.*, 331 S.Supp. 981 (D. Del. 1971) all cited and relied on in the District Court's denial of summary judgment here. 361 F.Supp. 112, Pet. A. 34-35.

The facts omitted from the joint proxy statement at bar are not in dispute. These facts were of substantial importance to TSC stockholders in considering the proposal which they were urged to accept by their own management. Without disclosure of these facts, relating to National's control, the market prices of National's securities, and the value of the National warrants, TSC stockholders could not make an intelligent appraisal of the proposal.

CONCLUSION

Respondent asks that the decision of the Court of Appeals for the Seventh Circuit be affirmed.

Respectfully submitted,

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